INDUSTRIAL ORGANISATION AND MANAGEMENT (DBC013)

(BACHELOR OF COMMERCE)

ACHARYA NAGARJUNA UNIVERSITY

CENTRE FOR DISTANCE EDUCATION

NAGARJUNA NAGAR,

GUNTUR

ANDHRA PRADESH

Lesson - 1

BUSINESS CONCEPTS

1.0 OBJECTIVES

After going through this lesson student can know

- → What is Business
- → Types of Business
- → Qualities of Businessman
- → Commerce, Industry, Trade etc.
- → Objectives of Business

Structure

1.1 INTRODUCTION

Every human being is busy in one activity or another.

All human activities are directed towards satisfying human wants. Depending on the nature of wants human activities may be classified into two categories.

1) Economic Activity, 2) Non-Economic Activity

Economic Activity : Human activities related to production and exchange of wealth are called economic activities. The main objectives of economic-activity are consideration and profitability.

Non-Economic Activity : Non-economic activities are primarily to satisfy social, religious, cultural or sentimental requiremnts of human beings. The main objective of non-economic activity are guided by love and affection.

Economic Activity - Classification : The economic activities carried out by human beings are classified into three cateegories. They are 1. Business, 2. Profession, 3. Employment.

1.2 CONCEPTS

1.2.1 BUSINESS

A business activity involves production, exchange of goods and services to earn profit. The literal meaning of the word 'Business' is a state of being busy.

When a person carries out production or purchase of goods and services for himself, cannot be a business activity. Production or purchase of goods and services should be carried out with an objective of earning some profit or consideration.

Various authors bring out different characteristics in their definitions.

According to L.H.Haney "Business may be defined as human activities directed towards providing or acquiring wealth through buying and selling goods."

According to Urwick and Hunt "a business is an enterprise which makes, distributes or provides an article or service which other members of the community need and are able and willing to pay for it".

Spiegal considers "all activities concerned with the production and sale of goods".

Therefore, "business is concerned with production and selling for profit".

1.2.2 Profession : Profession is an occupation involving the personal services of a specialised and expert nature. The service is based on professional education, knowledge, training etc. The services rendered by Doctors, lawyers, chartered Accountant, etc. come under this category. Every profession has a professional organisation. The professionals should be a member of a professional body and should follow the code of conduct. For example, a person entering law profession has to acquire a law degree and has to obey the guidelines and regulations of the Bar Council of India.

1.2.3 Employment : Employment involves when a person engaged by another in a work under an agreement or under a contract. There exists employer - employee relationship. The person engaged under employment works as per the directions of the employer. Reemuneration for such work takes in the form of wages or salary.

1.2.4 Firm : Firm is an individual organisation engaged in any business activity. The product or service in which it deals may be single or multiple. It may be of any size and any form. Form means sole trading concern, partnership firm or Joint Stock Company. A firm may be defined as "a unit of managemnt operating under a trade name organised either to extract minerals, produce or manufactured goods, or to sell goods or services, or to engage in two or three of these activities simultaneously".

Thus, a firm is an independently administered enterprise. The size may be small or big. The size may be measured by the value of output or by the labourers it employs, or by the value of its fixed assets like land, building, plant etc. It is a company or any other form of enterprise which engages in trade activity, owned by individual or group of people or by a government agency. It is the outcome of creativity and vision of an entrepreneur. The firm is established to serve the society and they have the social responsibility as they use the resources of the society.

Identical firms collectively are called industry. Suppose there are three different units producing different quantity of sugar, each unit is called firm. All the three units are collectively called sugar industry.

1.2.5 Plant : It is a term referred to the equipment needed for producing a product. Although the term plant used as a synonym for the term factory, plant means only the equipment used for the production of required product.

Plant is an integrated term which explains the functions of various types of machinery installed in a place to produce the product. Different types of machieries are used to produce a product. For example, to produce a product three processes are to be passed through. In each process a different type of machinery is used. It is collectively called Plant. The integrated operation of each machinery is called plant.

1.3 CHARACTERISTICS OF BUSINESS

(1) Entrepreneur : There must be someone to take initiative for establishing a business. The person who recognises the need for a product or service is known as entrepreneur. The entrepreneur visualises a business, combines various factors of production and puts them into a going concern.

(2) Economic Activity : Business includes only economic activities. All those activites relating to the production and distribution of goods and services are called economic activities. These are undertaken with profit motive.

(3) Production of Goods and Services : A business must involve production of goods and services. These goods may be of consumer goods and producer goods. Consumer goods are those which are purchased by ultimate consumer. Example : Soaps, Paste, etc. Producer goods are those which are used for production process. Example : Raw material, plant and machinery, etc.

(4) Exchange of Goods and Services : A business must involve exchange of goods and services with a profit motive. Production or purchase of goods and services for personal consumption do not constitute business. Purchase of goods by a consumer is not business while purchase of goods by a retailer constitutes business.

(5) Profit Motive : The profit motive is an important element of business. Any activity undertaken without profit motive is not business.

(6) Uncertainity : Business involves a large amount of risk and uncertainity. Furture is most uncertain. Unforeseen future uncertainities makes the business more risky. Industrial disputes, price changes, wars, floods, earthquakes etc., leads the business into losses.

(7) Continuity of Transactions : The business inolves the regular and constinuous transactions. If a person purchased a T.V. set and sells and earns profit on it, it does not constitute business. If he keeps stock of T.V. sets and sell them to earn profit becomes business.

(8) Creation of Utility : The goods are produced according to the tastes and requirements of the consumers. Business creates various types of utilities is goods. When raw materials are converted into finished goods creates form utility. The goods are transported from the place of production to the consumers create place utility. The process of storing goods and supplying them in times of need creates time utility.

(9) Satisfaction of Consumer : The ultimate aim of business is to supply the goods according to the tastes and requirements of the consumer. If consumer is satisfied, he will purchase it again and again. So the businessman should produce the goods and satisfy the consumer.

(10) Satisfying Social Needs : The business is a socio-economic institution. Business should aim at serving the soiety at large. It must look to the public good.

(11) Financing : A proper capital structure is a must for the success of the business. Business enterprises cannot move a step without finance. Business requirers two types of capital. (1) Fixed Capital (2) Working Capital. After estimating these financial requirements, businessman tries to findout the sources of finance.

1.4 TYPES OF BUSINESS

Business activities may be broadly divided into two categories. They are 1. Industry, 2. Commerce. Industry is concerned with manufacturing of goods and services. Commerce is concerned with the exchange of goods and services. There are two components in Commerce. They are (1) Trade, (2) Aids to trade.

Trade : The process of purchase and sale of goods and services is called trade.

Aids to Trade : The activities which facilitate Commerce are aids to trade. They are transportation, insurance, banking, warehousing, packing, advertising, etc.

1.4.1 Trade : Trade is an integral part of Commerce. All the activities of Commerce revolve around the trade. The activity of buying and selling of goods is trade :

Trade may be broadly classified into two categories.

1. Internal Trade

2. Foreign Trade

1. Internal or Home Trade : The internal or home trade refers to sale and exchange of goods within the boudaries of a country. Both the buyers and sellers live in the same country. Payments are made in the national currency. This trade is also known as ‘inland trade’ or ‘domestic trade’.

On the basis of scale of operations, the home trade can be classified into two types. (a) Wholesale Trade (b) Retail Trade.

(a) Wholesale Trade : This involvess the purchase of goods on a large scale from the producer and sold in smaller quantities to the retailer. A person, who is engaged in this type of trade is called a wholesaler.

(b) Retail Trade : This involves the purchase of goods in large quantities from the wholesaler and selling them to the final and ultimate consumers. The person, who is engaged in this type of trade is called a retail trader.

2. Foreign Trade or International Trade : It is also known as external trade. The trade which takes place between two or more countries is called Foreign or international trade. It means, buyer lives in one country and the seller is in another country. This type of trade involves payment in foreign currencies. It may be further classified into three categories. (a) Export Trade (b) Import Trade (c) Entrepot Trade.

(a) Export Trade : When a country sells goods to another country, it is called export trade. Export trade involves home goods for foreign use. For example, India sells poultry products to Gulf countries and tea to U.S.A.

(b) Import Trade : When a country buys goods from another country, it is called import trade. It consists of procuring foreign goods for home use. India buys machinery from west Germany, it is an import trade.

(c) Entrepot Trade : When goods are imported from one country and the same are exported to another country, such Trade is called entrepot trade. For example, electronic goods imported from Japan and exported to Africa.

1.4.2 Commerce

The exchange and distribution of goods and services is called Commerce. According to James Stephenson, “Commerce is an organised system for the exchange of goods between the members of the industrial world”. It establishes the link between the producers and the consumers.

The activities which facilitate commerce are (1) Banking (2) Transportation (3) Insurance (4) Warehousing (5) Packing (6) Advertisement, etc.

James Stephenson says, “Commerce is the sum total of those process which are engaged in the removal of several hinderances in the process of flow of goods and services from the producers to Consumers”.

Hindrances in the Process of Exchange of Goods and Services : There are many kinds of hindrances or obstacles standing in the way of trade or transfer of goods from the producer to the consumer. Commerce played an important role in removing the hindrances in the process of exchange of goods and services.

1. Hindrances of Persons : Goods are generally produced in few places, while the consumers spread throughout the country. There is no direct relation between producers and consumers. Trade acts as an arbiter between producer and consumer. The chain of wholesalers, retailers, brokers, agents etc. reduces the distance between producers and consumers. Thus, the trade facilitates easy exchange of goods by removing the hindrances of persons.

2. Hindrances of Place : Goods produced in a place are distributed to various places in the country and also exported to other countries. Commerce reduces the distance between the producers and consumers. The services like transportation, banking, insurance, packing etc are useful in removing the hindrances of transporting the goods from the place of production to the place of consumption.

3. Hindrances of Time : The production of some goods takes place only in a few seasons in large scale. But consumption of these goods is spread throughout the year in smaller quantities. During this time gap between the production and consumption, the product is to be stored in godowns and warehouses.

Example : The central and state warehousing corporation.

4.Hindrances of Finance : Sometimes Trader needs financial assistance. In such circumstances banks and other financial institutions provide finance in the shape of overdraft, loans or cash-credit. Hence banks play an important role to overcome the hindrances of finance.

5. Hindrances of Knowledge : The consumers may not be aware of the availability of various goods in the market. The absence of information about goods is a great hindrance in the way of consumers buying them. Advertisement helps in avoiding the hindrance of information about the availability benefits, features, price range etc., of the products in the market.

6. Hindrances of Risk : There is risk involved in transporting goods from one place to another. There may be a risk due to fire or theft. It acts as an obstacle in the development of trade. The insurance companies provide a coverage for all types of losses of goods.

1.4.3 INDUSTRY

Industry is the backbone of Commerce and Trade. The growth and development of trade and Commerce depends on the scope of industry. The activities related to the production of goods and services are known as industry.

The industries are classified as under :

1) Extractive Industries : These industries include activities in raising or extracting from the soil, climate, air, water or from beneathe the surface of the earth. Agriculture, fishing, mining, afforestation etc are the examples. These are the industries where nature does everything and man does very little to add to it.

2) Genetic Industries : These industries are engaged in re-producing and multiplying of certain species of animals and plants with the object of earning profit from their sale. Nature, climate and environment play an important part in these industries but human skill is also important. Nurseries, Cattle-breeding, Poultry farms are all come under genetic industries.

3) Manufacturing Industries : These are concerned with the working of raw materials or partly finished materials into furnished products. In these industries, role of nature is very less, and man takes the major part of the work. Examples : Engineering, textiles, iron and steel etc.

4) Construction Industries : These are engaged in the construction of buildings, roads, dams, bridges and canals. These industries use the products of manufacturing and extractive industries.

5) Service Industries : Service industries provide the necessary services directly or indirectly. Example: Banks, Insurance companies, Warehousing, etc.

Other Types of Industries :

On the basis of the size, technology and capital outlay, industries are classified as follows:

(1) Heavy Industries : Industries with huge capital, sophisticated technology and heavy machinery are known as heavy industries.

Example : Iron and Steel Industry, Ship Building etc.

(2) Light Industries : Industries set up with minimum capital and common technology are called light industries.

Example : Paper, Cement etc.

1.5 QUALITIES OF A SUCCESSFUL BUSINESSMAN

Success of any business depends on the managerial capabilities of businessman. There are certain qualities which are inherent but some other qualities which can be acquired by experience and training. Some of the important qualities which a businessman should possess are as follows :

(1) Knowledge of Business : The businessman should have a thorough understanding of his business. He should be clear about the aims and objectives of the organisation. Knowledge helps the businessman in solving complex business problems.

(2) Social Responsibility : The main objective of any business is to earn profit. In addition, every businessman has to serve public purpose. Every businessman has to do business not only for profits but also for public.

(3) Honesty : The most essential quality of a businessman is honesty. Businessman should be honest in dealings, then he can get good reputation for his products. Businessman can gain the reputation from his customer by supplying the best quality products. A dishonest businessman cannot exist a long period.

(4) Initiative : A businessman has to tackle many problems every day. He should be initiative and take the right decision in right time for the success of business.

(5) Relations with Employees and Customers: Customer satisfaction is essential to stay in the business. Business man should understand the tastes, likings and dislikings of his customers from time to time. Similarly, he should have the knowledge of the problems of his employees. Hence, he should to maintain good relations with his employees and customers.

(6) Adaptability : A businessman should be able to adjust according to the changing situations. He should be ready to face new challenges with courage and spontanity.

(7) Self-Characters : Businessman should have certain special qualities to run the business successfully such as impressive personality, hardwork, co-operative, courageous, displinarian, self-confidence, leadership qualities, etc.

1.6 OBJECTIVES OF BUSINESS

Every work is started with an objective. The main objective of a business undertaking is to earn profits. Profit earning is considered necessary for the survival of the business. But Now-a-days, the values of society have changed and society expects more from the business. The objectives of business may be categorised as under.

(1) Social Objectives : The business is required to meet varied needs of the society. The social objectives of business cna be explained as follows.

a) Supply of Quality Goods : The business should aim at consumer satisfaction. The supply of quality goods and services to consumers at reasonable price is the responsibility of the business. A business cannot exist in the longrun if it ignores consumers. It is the duty of the business to study wants and needs of consumers and provide them with quality of goods at reasonable prices.

b) Co-operation with the Government : Business should co-operate with the government in helping it to achieve the social objective. The business community should adopt a positive approach towards the policies of the Government.

c) Creation of more Employment : The business can help the society by creating more and more job opportunities. The business community should utilise its profits for further expansion of business activities which creates new job opportunities.

2) Economic Objectives :

a) Profit Earning : Business is started for earning profits. Profit earning is essential for the survival of any business. In modern business world, shareholders, debenture holders, management, banks, financial institutions, employees and government are interested in maximising wealth.

b) Creating Market : The aim of the businessman is to sell products. The businessman made an effort to retain old customers by supplying better quality goods at a reasonable prices and searches for new customers for increasing his sales.

3) Human Objectives :

a) Welfare of Employees : The businessman should look after the welfare of his workers. The workers should be rewarded for thier hardwork. Physical comforts, incentives, appreciation and proper working conditions should be provided to the employees. They will motivate the employees and give the best results.

b) Satisfaction of Consumers : Consumer satisfaction is the main aim of any business. The consumers should be provided quality goods at reasonable prices and service facility also. Businessman should observe the changing tastes, fashions and requirements of the consumers.

1.7 SUMMARY

a) All human activities are divided into (1) Economic, (2) Non-economic Activities.

b) Economic Activities are further divided into (1) Business, (2) Profession, (3) Employment.

c) Production of goods and services is Industry.

d) Distribution of goods and services is Commerce.

e) Purchase and sale of goods and service is trade.

f) Trade, Commerce, Industry are the parts of the business which serves the society through satisfying every-growing wants of human beings.

1.8 TERMINOLOGY

a) Business : Business is an economic activity.

b) Trade : Trade is an important component of Commerce. It is an activity of purchase and sale.

c) Commerce : Distribution of goods and services produced. It has two main components. Trade and Aids to Trade.

d) Trade : Activities of buying and selling.

e) Aids to Trade: Activities facilitate trade. Transportation, Insurance, Banking, etc.

1.9 SELF ASSESSMENT QUESTIONS

5 MARKS QUESTIONS

a) Economic and Non-economic activities.

b) Profession.

c) Business.

d) Home Trade and Foreign Trade.

e) Entrepot Trade.

f) Extractive Industries.

g) Manufacturing Industries.

h) Light Industries.

10 MARKS QUESTIONS

a) What is meant by Business ?

b) What are Types of Trade ?

c) What is Commerce ?

d) Objectives of Business ?

20 MARKS QUESTIONS

a) Explain the Characteristics of Business.

b) Explain the Hindrances of Commerce.

c) What is meant by Industry? Explain various types of Industries.

d) Explain the qualities of Businessman.

1.10 REFERNCE BOOKS

Industrial Oragnisation and Management	Proft. K.V.Sivaiah & V.B.M.Das
Industrial Organisation and Management	Y.K.Bhushan
Industrial Organisation and Management	M.C.Shukla

- Ch. Neela Krishnaveni
Lecturer in Commerce
Hindu College, Guntur.

LESSON - 2

BUSINESS ORGANISATION - TYPES - 1

2.0 OBJECTIVES

After going through this lesson student can know the following

→ Types of Business Units

→ Sole Trading Business - features, advantages, disadvantages

→ Joint Hindu Family - features, advantages, disadvantages

Structure

FORMS OF BUSINESS ORGANISATION

2.1 INTRODUCTION

Normally, Business enterprises are promoted to produce goods and services, to sell and to earn profits. The size, structure, nature of any business concern depends upon its capital investments, the risk involved and the policies adopted by the Governmnet.

In olden days, the needs and requirements of the people were very limited. As such, the size and volume of business was at a low level. In course of time, the population increased and the demand for goods and services increased correspondingly. This requires more investment and large labour and involves more risk. It led to the establishment of corporate enterprises. Thus in the process of evolution of trade, several forms of business organisations evolved to meet the needs of the people.

Sole Trading concern is suitable for running small business. Business unit which is managed by a single person is sole trading concern. Example : Vegetable shop, Sweet Shop etc.

Partnership form is apropriate for commercial activities such as transport agencies, chitfund companies etc.

The system of Joint HIndu families is unique in India. The Business of Joint Hindu family is controlled under the Hindu law.

Co-operatives are voluntary associations started with the aim of service to the members. They work on no profit - no loss basis.

A company is an association of persons who come forward to run a business with an object of earning profits.

The private enterprises are not willing to set up industries in backward areas. Hence the interference of the government is imperative in establishing industries.

2.2 CLASSIFICATION OF BUSINESS UNITS

Business enterprises can be (1) Non-Corporate Enterprise, (2) Corporate Enterprise.

(1) Non-Corporate Enterprises : Business units which can be started without registration are known as non-corporate enterprises. Ex.: Sole trader, Partnership farm, Joint Hindu family, etc.

(2) Corporate Enterprise : Business enterprises which are established under registration act are corporate enterprises. The business units which are started by the government are called corporations and started by private enterpreneurs as Joint stock company. Joint stock companies are classified as (i) Private Limited Companies (ii) Public Limited Companies (iii) Public Sector Undertakings.

Non-Corporate Enterprises : Business units which are of small size and with low investment come under this category. They can be divided as :

(i) Sole Trading concern.

(ii) Joint Hindu Family

(iii) Co-operatives Societies

(iv) Partnership Firm

2.3 SOLE TRADING CONCERN

2.3.1 Meaning

It is also called as sole proprietorship business or Individual proprietorship. Any business unit which is owned and controlled by a single individual is known as a sole trading concern. He is the founder as well as the controller of the business. In this, a single person subscribes the entire cpaital and arranges all factors of production. All the business decisions are taken by one person only. All the business is carried on by him with the assistance of relatives or employees. He enjoys all profits and bears all losses in the business alone.

It is the oldest of all the forms of business enterprises. It is said to be as old as civilisation. It is easy to set up and manage the sole proprietor's business. No legal formalities are required. His liability is unlimited.

Genrally, an entrepreneur starts his business as a sole trader, gains experience. Later he develops and expands his business into a large unit. Hence, the sole proprietory concern occupies an important place among all the business enterprises.

2.3.2 Definition :

Prof. L.H.Haney opines that the Sole Trading concern is "the form of business organisation, the head of which is an individual who is responsible, who directs its operations and who alone runs the risk of failure'.

James Stephenson defines the single propietor as "a person who carries on business exclusively by and for himself. He is not only the owner of the capital of undertaking, but is usually the organiser and manager and takes all the profits or responsibility for losses.

2.3.3 Characteristics

1. Individual Initiative : The proprietory concern comes into existence only through the efforts and initiative of a single person. He prepares the blue prints of business and arranges all factors of production. He may appoint required staff for his assistance. But he is responsible for all the activities. He enjoys all the profits and bears all the losses.

2. Management and Control : The sole trader manages the whole business himself. He prepares various plans and executes them under his own supervision. He employs required staff for his assistance but the ultimate responsibility lies with the owner.

3. Unlimited Liability : Liability of sole-trader is unlimited. Hence his private property is also liable for business obligations, if necessary.

4. Motivation : Sole trader takes all profits and bears all losses, if any. His efforts are rewarded directly. He is motivated and stimulated by the profits to expand his business activities.

5. Secrecy : All the decisions are taken by the owner himself. He maintains secrecy in all the business activities. Secrecy plays an important role for the success or failure of the business. By maintaining business secrecy sole trader avoids competitors entering into the same business.

6 Uncertain Existence : In sole trade business there is no seperate existence of the business with the owner. The business and the owner exist together. The business is dissolved if the owner dies or become insolvent.

7. Limited Area of Operations : A sole trading business has generally a limited area of operations. Because of the limited resources and managerial abilities of sole trader there is less possibility to expand the business.

8. Risk : In sole trading concern, the sole trader and his business are seperate entities. Nobody shares his profits or losses. Loss in business is his loss and Liabilities of the business are his liabilities.

9. Government Regulations : The registration is not necessary except in certain trades such as medical shop and restaurants. There are no statutory controls. Similarly no restrictions are imposed by the Government.

2.3.4 MERITS

1. Easy in Formation : Sole Trading concern is absolutely free from legal formalities. It can be commenced very easily and quickly. The establishment costs are also very less.

2. Better Control : The sole proprietor is responsible for all the business activities. He controls all functions of the business. He himself takes decision in right time. The centralised direction and personal control result in unifornity of action and effective co-ordination.

3. Maintenance of Business Secrets : Secrecy is vital for any business. A sole trader concern is a singleman's business, he keeps all the secrets within himself. As the accounts need not be published, the dealings and profits are not known to the public. This enables the sole trader to maintain secrecy from his business competitors.

4. Easy to Raise Finance : The sole trader works hard and earns goodwill for the firm. As a result, his credit worthiness enhances in the market. More over, the sole trader bears unlimited hability. Hence, the creditors feel secure in extending credit to sole trader.

5. Promptness in Decision Making : All the business decisions are taken by a single person. He can take prompt decisions. Delay in decision making results in loss of opportunities to earn profits.

6. Inexpensive Management : The sole trader is the owner, manager and controller of the business. He personally supervises various activities and can avoid wastage in the business. He maintains the accounts of business by himself. Thus managerial and clerical costs are saved to a large extent.

7. Direct Realtions with Consumers : In sole proprietorship the owner can have direct contact with customers and employees. He can know the relations and preferences of consumers. It enables him to make necessary changes in the quality and design of his products. It will help him to boost his sales. He can also concentrate on consumer service.

8. Self-employment : This form of organisation offers the means of self-employment. Those who do not want to serve others or those who cannot get a suitable job can easily start a small sized business unit as a sole-trader.

9. Healthy Relations with Employees : A sole trader is in a position to maintain direct relations with his employees. This enables the employer and employees to understand and appreciate the difficulties of each other. A sole trader cna solve the grievances of his employees. This leads to a healthy relation between employer and employee which is necessary for the success of the business.

10. Benefit of Goodwill : A sole trader passes on the business goodwill to his successor. Generally sole trading concern is dissolved on death of the owner. But in relatity the same business is continued by a heir because of its inherited goodwill.

11. No Legal Restrictions : There are no legal requirements for starting a business. There is no special act governing the work of sole trading concern. There is no restrictions to change the nature of business. Dissolution of the business is also easy. He is taxed as an individual but not as a business unit.

12. More Flexible : As it run by an individual, the business is highly flexible in character. Sole trader is free to change the nature of business and to refix the prices. He can make changes effectively and quickly to run the business more profitable and efficient.

13. Socially Desirable : One man business is generally on a small scale basis and is scattered. It helps in avoiding concentration of wealth. Sole trade business also provides competition to other businesses. Sole trader develops the qualities of self-reliance, self-confidence, responsibility, tact and initiative in the individuals. Thus it generates social values.

2.3.5 DEMERITS

1. Limited Resources : The resources of a sole proprietor are limited. He makes investments from his family sources only. If he wants to raise finance from financial institutions, he has to show securities. The sole trader cannot offer much security, so he cannot get much help from financial institutions. The capacity for expanding business operations is limited for want of resources.

2. Limited Managerial Ability : The managing capacity of the proprietor is limited. One person may not be expert in each and every function of the business. He will not be able to devote sufficient time for all types of activities. So sole trader will not be able to survive effectively. Limited managerial capacity will hinder the growth of concern.

3. Uncertain Continuity : The business continues as far as sole trader is alive. In case of mobility or death, the eixstence is uncertain. The successors of the sole proprietor may not have an aptitude or ability to continue in the business. The closure of a business will cause inconvenience to the customers and it stands as an impediment for the growth of the unit.

4. L**imited Scope of Employees** : A sole trader cannot attract trained and qualified persons because of limited career opportunities and uncertain existence. A sole trader cannot offer financial incentives to employees because his activities are on a small scale. The employees will try to join in good concerns whenever an opportunity arises.

5. No Large Scale Economies : A small scale concern cannot economise in purchase, production and marketing. A large scale enterprise can have such economies due to wholesale buying. In a sole trade concern overhead expenses are also more. So this type of concern cannot enjoy the benefits of large scale economies.

6. More Risk : A sole proprietor is to take all decisions by himself. So there is possibility of taking wrong decisions. In other forms of organisations, the decisions are taken by a group of persons. So the possibility of mistakes and wrong decisions is minimised. Lack of counselling may create difficult situations.

2.4 JOINT HINDU FAMILY

2.4.1 Introduction

This is a form of business organisation which exists in India only. And it is only the Hindus who can form this organisation as the name itself indicates. Outsiders cannot become members of this organsation. Membership to this type of organisation is either by birth or by marriage to a male person who is already a member of a Joint Hindu Family. Membership to a Joint Hindu Family is automatic and cannot be avoided, if one takes his birth in a Hindu Family which is running a business.

It is also knows as undivided Hindu Family. It is a family consists of common ancestor, which is a must to bring a Joint Hindu Family into existence all his male decendants upto any generation along with their wives and unmarried daughters. The death of a common ancestor does not bring the Joint Hindu Family to an end. It continues till perpetuity, as upper links removed by death and lower ones are added by birth.

All the affairs of the Joint Hindu Family are controlled and managed by one person who is known as Karta or Manager. According to Hindu Law, the senior most male member of the family is 'Karta' by virtue of his position in the family. Kartha's powers are almost unlimited. He acts on behalf of the other members of the family. Neither he is accountable to anyone nor prepares accounts.

2.4.2 Schools of Hindu Law

On the baiss of the schools of Hindu Law, Joint Hindu Family is considered under two heads.

1. Mitakshara 2. Dayabhaga.

1) Mitakshara : Mitakshara says of son's right by birth in the joint family property. This means, when a son is born in family, he acquires an interest in the property jointly held by the family. The interests of all sons are equal. In this type of Joint Hindu Family there is community of ownership and unity of profession. The members of a Hindu undivided Family who own a business are called Co-parceners. Such a business organisation is managed by the head of the family called the Karta. However, if all the members agree, a junior member of the family can act as the Karta.

In Mitakshara Joint Hindu Family, property cannot be alienated either by father or by other co-perceners can alienate upto his own undivided share in the joint family property.

The share of a member of Hindu undivided family depends and fluctuate on the births and deaths in the family. The share decreases with birth and incrase with death in the family. Ordinarily, the property belonging to the family cannot be transferred by any one.

Under the old Hindu Law, female was not entitled to any share in the property. Btu with the passage of Hindu Succession Act of 1956 even females have been included in the list of persons who acquire share in succession.

2) Dayabhaga : According to this law, the property can only be inherited. The share of each member is specified. It does not fluctuate on birth and deaths in a family. Further any member can transfer his share of the property in the family.

2.4.3 Rights and Liabilities of Karta and Co-parceners

The Karta who is actually the manager of the firm run by the family occupies a very important and unique position. No other member of the business cna question his action in running the business. The Karta is liable to make good to the other members of the family their shares of all sums which he has misappropriated. The Karta has the power either to carry on the business or to close down.

The Co-parceners have no right of participation in the management. Further they have limited liability i.e., they are liable only to the extent of their share in the business.

2.4.4 Characteristics or Features of Joint Hindu Family Business

1) Governed by Hindu Law : The control and management of the Joint Hindu Family firm is done according to the uncodified or codified Hindu Law. The unccodified law consists of two schols, Mitakshara and Dayabhaga. In the same way rights and duties of its members are governed by uncodified Hindu Law.

2) Membership : The membership of the family can be acquired only by birth. An outsider can be admitted by adoption. Marrying a male member of the family also confers membership.

3) Management : The family affairs are managed by the senior most male member of the family known as Karta or Manager. The powers of management are unlimited. He may manage or mis-manage, it cannot be questioned by any member. But the management is more effective due to nature love and affection with the members of the family.

4) Limited Liability of Others : All the members in a Joint Hindu Family have limited liability to the extent of the joint property of the family. The self occupied property of any member cannot be taken to repay the loans taken by the family. It is only the joint family property which is laible for satisfying debts. However, Karta is personally liable for loan taken on promissory note.

5) Continuity : It continues forever. The death, insolvency, insanity of the any member in the family do not bring the joint family firm to an end. There is no limit to its membership number also.

6) Membership : A person from its very birth becomes the member of the Joint Hindu Family. This is an important feature of this business organisation.

7) Accounts : Accounts are maintained by Karta but this is not obligatory on his part. He is not accountable to any member and no member can ask for the same.

8) Implied Authority of Karta : There is an implied authority in favour of Karta to contract debts and pledge the credit and property of the family for ordinary purposes of family business. These are binding on the entire family. No other member is having such an authority.

2.4.5 Advantages

1. Centaralised Management : The management of a Hindu Joint Family Firm is centralised in the hands of Karta. He is the eldest and the most experienced person gives a very disciplined management. This results in smooth functioning of the business. No other member interferes in his management.

2. Utmost Secrecy : Joint Hindu Family firm is managed by a single man 'Karta'. He can do it with utmost secrecy. He can keep a thing secret even from the members of the firm.

3. Quick Decision : Joint Hindu Family Firm is a single man show. As Karta is the decision-maker, he can take the decision quickly. Further it is advantageous that the decision in final and unchallengeable.

4. Credit Facilities : In Joint Hindu Family firm the credit facilities are more. The reason is that the liability of the Karta is unlimited. Moreover, Karta is having personal relations with others, which are also helpful in raising credit.

5. Work according to Capacity : Work can be divided among the co-parceners on the basis of their capacity and talents. A person who is more strong than others may be asisgned work of physical nature. Disabled and infants are not required to do any work at all.

6. Natural Love Between the Members : In Joint Hindu Family Firm, it is the natural love and affection which the members are having for each other. This helps the smooth working of business. Every coparcener is guaranteed a minimum share of profits irrespective of their contribution to the working of the firm.

7. Economy: Economy is must for the success of any business. It is well balanced and maintained in Joint Hindu Family Firm. This may be due to hanging sword of partition of family on the neck of Karta.

8. Knowledge to Young Generation : The younger members of the family can get the benefit of knowledge and experience of elder members of the family.

9. Limited Liability : The liability of all the members of the family firm is limited to their undivided shares in the propoerty of the family. How ever Karta's liabilities are unlimited.

2.4.6 Disadvantages

1. No reward for Efficiency : There is no encouragement to work hard because profits are divided equally. The persons who work more efficiently and dedicatedly are not rewarded. Due to this the members may try to avoid work.

2. Limited Capital : The investment of this type of firm is limited only upto the resources of the family. They may not be sufficient to meet the business requirement and for the expansion of the business.

3. Limited Managerial Skill : Only the eldest male member of the family is to manage the family business. He performs all the functions of the management. He may not be well conversant with the knowledge of business skills and other problems of managemnt. The views of younger members will not be approved by the elder members. This leads to conflict between old and young members.

4. Suspicion : The Karta is empowered with vast power of secrecy and he can keep a thing secret from its members. But there is no restriction on him. This gives birth to suspicion among the members themselves which can be disastrous for the joint Hindu family.

2.5 DIFFERENCE BETWEEN SOLE TRADING AND JOINT HINDU FAMILY FIRM

Sole Trading	Joint Hindu Family Firm
1. This form of business is owned by a single person.	1. This form of business is owned by the family members.
2. This is not governed by any law	2. This is governed by Hindu Law
3. Liability of sole trader is unlimited.	3. The liability of Karta is unlimited but of the coparceners is limited to their share in the firm.
4. There is no possibility of division of work in sole trading concern.	4. The work can be divided in Hindu undivided Family Firm.
5. Credit worthiness of sole trader is less.	5. Credit Worthiness of Joint Hindu Family Firm is better.
6. The life of sole trading concern is less.	6. Joint Hindu Family Firm has a longer life.
7. Sole trader enjoys all the profits and bears all the losses.	7. Profits and losses are shared in a Joint Hindu Family Firm
8. As there is single person there is no scope for dispute	8. There is Chance of disputes and conflicts among the members of the family firm

2.6 SUMMARY

a. Business carried on by a single person is sole trading concern.

b. Joint Hindu Family Firm is prevalent in India only.

c. Joint Hindu Family Firm is governed by Hindu Law.

d. Affairs of Joint Hindu Family are controlled and managed by one person 'Karta'.

2.7 SELF ASSESSMENT QUESTIONS

5 Marks Questions

1. Various types of Business Organisations.
2. Mitakshara School of Hindu Law.
3. Dayabhaga School of Hindu Law.
4. Position of Karta in a Joint Hindu Family Firm.

10 Marks Questions

1. What are the essential characteristics of Sole Trading concern.
2. What are the characteristics of Joint Hindu Family Firm.

20 Marks Questions

1. Explain the characteristic features, merits and demerits of sole trading concern.
2. Explain the characteristic features, merits and demerits of Joint Hindu Family Firm.
3. Distinguish Sole Trading and Joint Hindu Family Firm.

2.8 REFERENCE BOOKS

1. Industrial Organisation and Management - R.K. Sarma and Shashi K. Gupta
2. Industrial Organisation and Management - Y.K.Bhushan
3. Industrial Organisation and Management - Prof. K.V.Sivaiah & V.B.M.Das
4. Industrial Organisation and Management - M.C.Shukla

- Ch.Neela Krishnaveni
Lecturer in Commerce
Hindu College, Guntur.

Lesson – 3

PARTNERSHIP

3.0 Objectives

After going through this lesson student can know

- ➔ Partnership Business
- ➔ Characteristics, Advantages, Disadvantages
- ➔ Partnership Deed
- ➔ Kinds of Partners
- ➔ Rights, Duties, Obligations of Partners
- ➔ Registration and Dissolution of Partnership Firm

Structure

PARTNERSHIP

3.1 INTRODUCTION

Partnership firm is another form of businers organisation. The two deficiencies of sole trading concern are shortage of capital and lack of managerial skills. Moreover risk bearing capacity of an individual was also limited. More persons were required for supervising different functions. Partnership form of organisation can overcome these deficiencies.

The partnership may come into existence either as a result of the expansion of the sole trading concern or by means of agreement between two or more persons. When the size of business expands, the proprietor finds it difficult to manage the business and is forced to take outsiders, who provides additional capital and assistance to manage the business on sound lines.

Two or more persons can join together to establish a partnership firm. It has a legal status. It is covered by the Indian Partnership Act, 1932. There will be union of Capital, Skill, Organising Power and Managerial Ability. The profit or loss is shared according to agreed proportions.

3.2 DEFINITION

According to L.H. Haney, partnership is “The relationship between persons who agree to carry on business in common with a view to enjoying ‘private gain’.

John A. Shubin opines that “Two or more individuals may form a partnership by making a written or oral agreement that they will jointly assume full responsibility for the conduct of the business”.

According to sec 4 of partnership Act, 1932, “The relation between persons who have agreed to share profits of a business carried on by all or any of them acting for all”.

3.3 CHARACTERISTIC FEATURES OF PARTNERSHIP

1. Association of Persons: In partnership form of organisation, there must be at least two persons. Partnership is the outcome of a contract, so there must be two or more persons. Minor cannot form a partnership firm as they are incompetent to enter into a contract. According to sec 11 of the contract Act, there is no maximum limit on partners in partnership Act. But according to Companies Act, the maximum number of partners cannot exceed ten in banking business and twenty in any other business.

2. Contractual Relation: According to partnership Act, the relation of partnership arises from contract but not from status. The contract may be oral or written but in practice written agreement made because it helps to settle the disputes if arise later on.

3. Earning of Profits: The purpose of the business should be to make profits and distribute them among partners. If a work is done for charity purposes or to serve the society it will not be called partnership. The main motive of partnership is earning of profits.

4. Limited Authority: There is an implied authority that any partner can act on behalf of the firm. The business will be bound by the acts of partners.

5. Unlimited Liability: In partnership, every partner is liable to an unlimited extent. He is liable till the last paisa of the firm’s debt is paid, irrespective of the fact that the liability might have been incurred by himself or by other partners of the firm. The partners are liable individually and collectively.

6. Principal and Agent Relationship: In partnership the relationship of principal and agent exist. It is not necessary that all partners should work in the business. Any one or more partners can act on behalf of other partners. Each partner is an agent of the firm and his activities bind the firm. He also acts as a principal because he is bound by the activities of other partners.

7. Good Faith: The very basis of the partnership business are good faith and mutual trust. Every partner should act honestly and give proper accounts to other partners. The partnership cannot run if there is suspicion among partners. It is very important that partners should act as trustees and for the common good of all. Distrust and suspicion among partners lead to the failure of many firms.

8. Existence of Business: Partnership can only be for some kind of business. The term business includes any trade, profession or occupation. By business we mean all the activities concerning production, distribution and rendering services for the purpose of earning profits.

9. Restriction on Transfer of Shares: No partner can sell or transfer his share to anybody else without the consent of the other partners. In case any partner does not want to continue in the partnership, he can give a notice for dissolution of the firm.

10. Common Management: Every partner has a right to take part in the running of the business. It is not necessary for all partners to participate in day-to-day activities of the business but they are entitled to participate. Even if partnership business is run by some partners, the consent of all other partners is necessary for taking important decisions.

11. Partners and Partnership are one: A partnership firm has no separate entity from the partners. No firm can exist without partners. The rights and liabilities of partners are the rights and liabilities of the firm. Partners have implied authority to bind the firm for their acts.

12. Capital: The partners contribute to the capital of the firm. It is not necessary to have capital in profit sharing ratio. A partner can be admitted to the firm even without contributing to the capital. It is not essential that all partners must contribute to the firms capital.

13. Protection of Minority Interest: All-important decisions are generally taken by contensus. It ensures protection of those who may not agree to the majority view point. A partner may even ask for the dissolution of partnership if he feels aggrieved.

14. Continuity: There is no true limit for the continuity of a partnership firm. It continues till the time the partners want it to go. Death, insolvency or any misunderstanding among the partners may dissolve the partnership. Dissolution of partners may not necessarily mean dissolution of the firm. The remaining partners may continue the firm after meeting the claims of outgoing partners.

3.4 ADVANTAGES OF PARTNERSHIP FORM OF ORGANISATION

Partnership form of organisation is suitable for medium size businesses where personal efforts of entrepreneurs are essential. The following are the advantages of partnership.

1. Easy to form: A simple agreement among partners is sufficient to start partnership firm. The registration of the firm is optional.

2. Large Resources: The resources of more than one person are available for the business. More partner can be admitted if capital needs are large. The partnership concern can also arrange funds from the outside resources.

3. Managerial Talents: Different functional departments may be managed and controlled by different partners. The talent, expertise and knowledge of partners in different fields can be used for the welfare of the business. It increases the efficiency of the business resulting in more profits.

4. More Credit-Worthiness: The partners may have sufficient contacts in the market. The liability of the partners being unlimited, they will be able to raise more finances. As compared to a sole-trading concern, partnership concern has more credit-worthiness.

5. Prompt Decision-making: The partners meet frequently and they can take prompt decisions. The firm will not lose any business opportunities because of delay in taking a decision.

6. Sharing of Risk: The risk of business is shared by more persons. The burden of every partner will be much less as compared to the burden of sole-trader. Further more, the business expansion will not be hampered for fear of risk.

7. Relation between reward and work: The partners try to put more labour to earn more and more profits. These is a direct relationship between reward and work. The more they work, the more they be benefited.

8. More possibility of Growth and Expansion: As compared to a sole-trading, partnership concern has more possibilities for expansion of growth of the business activities. The partner can contribute more and manage the activities more systematically.

9. Close Supervision: The partner themselves look after the business. So they can avoid wastages. They have direct access to the employees and can encourage them for more production. The management of partnership is much cheaper when compared to joint stock company.

10. Flexibility of Operations: Government approval is not necessary for making changes in the business set-up. There can be any change in managerial set up, capital and scale of operations.

11. Secrecy: The firms are not required to publish any accounting information to outsiders. The partners can keep the business secrets to themselves. The competitors do not know about the exact position of the business.

12. Protection of Minority Interests: Every partner has a right to participate in the management of the business. All-important decisions are taken by the consent of all partners. If majority decision is enforced on minority then effected partners can get the business dissolved.

13. Easy Dissolution: The partnership can be dissolved on insolvency, lunacy or death of a partner. If the partnership is at will, then any partner can get the firm dissolved by giving notice to other partners. No legal formalities are required at the time of dissolution. So it is easy to start as well as dissolve a partnership concern.

14. Democratic Administration: All partners may take active interest in the working of the firm. All the partners are consulted on important decisions. Generally, strategic decision are taken by concensus only.

15. Saving in Managerial Expenses: There are savings in expenses of a partnership firm. The partners divide all important functions among themselves and look after them.

3.5 DISADVANTAGES OF PARTNERSHIP

1. Limited Resources: There is restriction to the number of partners in a firm, i.e., ten in case of banking business and twenty in any other business. Hence the capital is limited to the extent of financial ability of each partner in the firm. They cannot finance for bigger ventures.

2. Unlimited Liability: The liability of partners in the firm is unlimited. The personal properties are held liable for clearing the debts and obligations of the firm. Partners owning private properties have to be careful to become partners in a firm.

3. Instability: The partnership concern suffers from the uncertainty of duration. The partnership may be dissolved at the time of death, insolvency or lunacy of a partner. The discontinuity of the business is a social loss and it causes inconvenience to the consumers and workers.

4. Mutual Distrust: The mutual distrust among partners is the main cause for the dissolution of partnership concern. It is difficult to maintain harmony among partners. They may have different opinions and may not agree on certain matters. This may lead to the dissolution of the firm.

5. Limitation on Transfer of Shares: A partner has no right to transfer his shares to third party without the consent of other partners.

6. Burden of Implied Authority: A partner can bind the business by his acts. A dishonest partner creates problems in business. The other partners will have to meet the obligations incurred by the partner. The provision of implied authority may create problems for the business.

7. Lack of Public Faith: Partnership concern has no obligation of publishing accounts. Public is unaware of the exact position of the business. There is suspicion in the minds of public about the profits and financial position of the firm. So partnership concerns lack of public confidence.

8. Lack of Prompt Decisions: Every partner is entitled to take part in the management of the firm. Collective decisions may lead to delay and sometimes lead to misunderstanding. Delay in decision making leads to a loss in business. Lack of harmony among partners often leads to the dissolution of the firm.

9. Cautious Approach: Unlimited liability of partners leads to cautious approach on the part of partners. Risk bearing capacity of partners may also be limited. They try to avoid decisions where risk is involved. Because of this nature, a number of opportunities may be lost.

10. No Independent Legal Status: The partners and the partnershipfirm are treated as one and the same. Partners have no separate entity and partnerships do not enjoy an independent legal status.

3.6 PARTNERSHIP DEED

If the partners work collectively with understanding and cooperation then the firm can run smoothly. If there are disputes and conflicts among the partners resulting to the closure of the firm. Hence, to avoid the disputes and conflicts among the partners there must be an agreement between the partners.

In order to constitute a partnership there must be an agreement between the parties. The agreement may be oral or in writing. The document which contains an agreement among the partners is called “Partnership Deed”. The deed must be duly stamped and signed by all the partners.

The deed should be drafted properly incorporating all the necessary terms and conditions of partnership. These terms and conditions may vary from firm to firm.

Contents: The Partnership Deed usually contains the following information.

1 Name of the firm

2 Names, Addresses, Occupation of the Partners

3 Nature of the business to be carried on.

4 Amount of capital and contribution of each partner.

5 Profit sharing ratio.

6 Duration of partnership.

7 Amount of with drawals to be allowed to each partner.

8 Rate of interest payable on capital and chargeable on with drawals.

9 Salary, Commission or Bonus payable to partners.

10 Evaluating Goodwill, Profit sharing ratio, Revaluation of assets and liabilities at the time of Admission, Retirement or Death of a partner.

11 Proceedure for dissolution of the firm and settlement of accounts.

12 Arbitration clause for settlement of disputes among partners.

13 Division of work among the partners.

14 Maintenance of Book of Accounts and Audit of Accounts.

15 Rights duties and obligations of partners.

16 Additional capital introduced by partners.

This is not exhaustive and final list of clauses, which can be inserted in the partnership deed. If partnership deed is silent in any point, then provisions of partnership act will apply. The deed is not rigid in nature and the contents of the deed can be altered from time to time with the consent of all the partners of the firm.

3.7 REGISTRATION OF PARTNERSHIP FIRM

The registration of partnership is not compulsory under Indian partnership Act. But there are certain previlages, which are allowed to registered firm. To avail certain advantages under law the firm must be registered with the Registrar of firms of the state. Registration of firm does not provide a separate legal entity to the concern as in case of Joint Stock Company.

3.7.1 Procedure of Registration: The Proceedure is divided into two parts.

1. Filing an Application: The first thing to be done is to file an application with the Registration of firms on a prescribed form. A small amount of registration fees is also deposited along with the application. The application should contain the following information.

    1. The name of the firm.
    2. The Principal place of business of the firm.

3. Date of a Commencement of the Business.
4. Names and Addresses of Partners.
5. Duration of the firm.
6. Profit & Loss Sharing Ratio.

The application form should be verified and signed by each partner or by his duly authorised agent.

2. Certificate: The particulars submitted to the Registrar are examined, whether all required legal formalities have been followed or not. If everything is approved, then the Registrar shall record an entry in the Register. Then the firm is considered to be the registered firm.

Alteration of Particulars: Whenever a change or alteration is made then it should be communicated to the Registrar of firms and a suitable change is made in the register.

Following changes or alterations are to be sent to the Registrar.

1. Any change in the name of the firm.
2. Any change in the principal place of the business.
3. Constitutional change i.e., old partner may retire and a new partner may be added.
4. Any change in the name of a partner or his address.
5. When a minor partner attains the age of majority and he elects to become or not to become a partner.
6. When the firm is dissolved.

3.7.2 Advantages of Registration:

1. **Advantages to the firm**: The firm has a right to the third parties in civil suits for getting its rights enforced. In the absence of registration, the firm cannot sue outside partners in courts.
2. **Advantages to Creditors**: A Creditor can sue any partner for recovering his money due from the firm.
3. **Advantages to Partners**: The partners can approach the law against each other in case dispute arise, among the partners. The partner can sue the outsider also for recovering his money.
4. **Advantages to Incoming Partners**: A new partner can fight for his rights if the firm is registered. If the firm is unregistered, the new partner has to depend on the honesty and mercy of other partners.
5. **Advantage to outgoing Partner**: The registration of a firm is benefited to outgoing partner also. On the death of a partner his successors are not responsible for the liabilities of the firm after the death of the partner. The retiring partner continues to be responsible up to the time he does not give public notice. The public notice is not registered with the Registrar and he ceases his liabilities from the date of this notice. So it is necessary to register the firm for these advantages.

3.8 KINDS OF PARTNERS

There are different kinds of partners and they may be classified as under:

1. **Active Partner or working Partner**: A Partner who not only invest his capital in the business but also participates actively on the management of the firms business is called Active Partner. He may act in different capacities such as Manager, Organiser, Adviser and Controller of all the affairs of the firm.

2. **Dormant or Sleeping Partner**: A partner who contributes capital, shares profits and bears losses of the business but does not take interest in running the business of the firm. Sleeping partner is liable for the liabilities of the business like other partners. He cannot bind the business i.e., firm, to third parties by his acts. He is not known to the public as a partner. So he may be called as a 'Secret Partner'.

3. **Nominal Partner**: A Partner who does not contribute any capital nor does he shares profits of the business. He does not take any active role in the management of the business. Simply he lends his name and fame in the interest of the firm. So that the business may get more credit in the market or may promote its sales. However, he remains liable for the debts and liabilities of the firm.

4. **Partner in Profits only**: A person may become a partner for sharing the profits only. He contributes capital and is also liable to third parties like other partners. He is not allowed to take part in the management of the business.

5. **Partner by Estoppel:** When a person is not a partner but poses himself as a partner, either by words or in writing or by his acts he is called a partner by estoppel. A partner by estoppel shall be liable to outsiders who deal with the firm on the presumption of that person being a partner and does not contribute anything to the business.

6. **Partner by Holding out**: When the third parties declare any person as partner and if that person does not deny that fact knowingly and intentionally, he is called "Partner by Holding Out". Such a person does not contribute any capital and will not enjoy any rights to participate in the management of the firm. However, the partner is liable to the third parties to the extent of credit granted to the firm, considering him to be a partner.

7. **Sub Partner**: A partner may associate anybody else in his share in the firm. He gives a part of his share to the stranger. The relationship is not between the sub-partner and the firm but between him and the partner. He is not liable for the debts of the firm.

8. **Minor as a Partner**: A minor is a person who has not yet attained the age of majority. Partnership is a contractual relationship and minor being incompetent to enter into contract. However a minor may be admitted to the benefits of the existing partnership with the consent of all partners. Minor is not personally liable for the debts of the firm. His share in partnership property and profits will be liable for the debts of the firm.

3.9 RIGHTS, DUTIES AND OBLIGATIONS OF PARTNERS

The rights, duties and liabilities of the partners are determined by the provisions of the Indian Partnership Act, 1932. They are specifically provided in partnership deed. In case the deed fails to provide any point, the provisions of the act are applicable.

3.9.1 Rights of Partners

Every Partner of the firm has a right

1. To take part in the management of the business of the firm.
2. To express his opinion on any matter relating to the firms business. The decisions on the ordinary issues of the business may be taken on the opinions of the majority of partners where for all important matters consent of all the partners is required.
3. To share the profits of the firm equally, unless otherwise mentioned in partnership deed.
4. To inspect books of accounts of the firm and copy them.
5. To prevent the admission of the new partner without the consent of all partners.
6. To receive interest at 6% per annum on excess money supplied over his capital.
7. To get himself reimbursed with the amount spent by him in the ordinary course of business.
8. To claim compensation from the firm for any loss suffered or any liability incurred by him in the ordinary course of firm's business.
9. To prevent a change in fundamental matters.

Implied authority of a partner:

A partner is an agent of the firm and his acts can bind the firm. The acts must be for the purpose of the business of the firm. The act is done in the firm's name and to bind the firm. This authority of a partner is called his implied authority.

Under implied authority, a partner may bind the firm for such type of acts.

1. He may purchase and sell the goods of the firm.
2. He may accept the payment of debts due to the firm and issues valid receipts.
3. He may hire employees for the partnership business.

In case of a trading firm a partner has the following additional powers:

1. He may make, draw or accept or otherwise deal with negotiable instruments in the name of the firm.
2. He may employ an attorney on behalf of the firm.
3. He may engage and instruct an advocate in a suit by or against the firm for debt.

3.9.2 Duties of Partner

The partnership business will be successful if all the partners show interest in running the business. They must be duty minded. For the success of partnership firm all the parners work ogether in a team spirit.

Every partner should :

(1) Carry on the business with interest to attain the maximum common benefit.
(2) be fair and faithful to other partners.

(3) maintain true and correct accounts of the firm.
(4) indemnify the firm for loss caused by his wilful negligence or fradulent conduct.
(5) disclose the true information and details relating to the firm to the other partners.
(6) not to carryon any business in competition with the business of the firm.
(7) not to earn profits secretly with the firm's name such as commission etc.
(8) not to use firms assets for personal purpose.
(9) not to transfer part of his share to any body without the consent of other partners.
(10) act within the powers given to him. If he performs beyond the powers, resulting in loss, the partner is liable to the firm.

3.9.3 Liabilities of a Partner

All the partners are liable to each other as per the partnership deed. In addition they are also liable to the outsiders. The following are the liabilities of partners against the third parties:

(1) The liability of each partner is unlimited. If the firms assets are insufficient to meet the firm's debts, the private properties of the partners are also liable.

(2) The liability of the partners is joint and several. They are individually as well as collectively liable for the debts of the firm. If any partner makes any loss to the outsider, then the partner as well as the firm are liable to that outsider.

(3) The minor partner of the firm is not personally liable for the debts of the firm. But his share in profits and assets can be held liable.

(4) The newly admitted partner shall not be liable for the debts incurred by the firm before his admission, unless there is agreement.

(5) The retiring partner is not liable for the debts of the firm incurred after his retirement.

3.10 KINDS OF PARTNERSHIP

Different kinds of partnership may be explained as :

1. General Partnership 2. Limited Partnership

3.10.1 General Partnership

In this type of partnership, the liability of members in unlimited. All the partners personally and collectively are liable for the obligations of the firm. All partners can take part in the working of the business. In India, this kind of partnership exists. On the basis of its diuration partnership can be divided as

a) Particular Partnership : When a partnership is started for certain work it is called particular partnership. When the work is completed the partnership comes to an end. The partnership may also be for a limited period. It will be dissolved at the expiry of that period.

b) Partnership at Will : This type of partnership is neither for a fixed period nor for a particular purpose. The partnership at will continues upto the time the partners have faith in each other. The life of partnership is not limited by time and work. The strength of this partnership depends upon the mutual trust and confidence among the partners.

2 Limited Partnership : In limited partnership, the liability of some partners is limited while liability of some partners is unlimited. The partners with limted liability are called special partners while those with unlimited liability are called general or active partners. The liability of special partners is limited only to the extent of their capital while the liability of general partners can go beyond their capital. This type of partnership can be seen in U.S.A. and several Europe countries.

3.10.2 Features of Limited Partnership

1. There are two classes of partners i.e., special and general partners. There must be atleast one general partner whose liability will be unlimited and atleast one partner should be a special partner with limited liability.
2. The special partners can not bind the firm by their acts.
3. The special partner only invest money but cannot take part in the business. The day-to-day work is done by genral partners only.
4. The limited partnership must be registered under acts. Non-registration of the firm will be treated as general partnership.
5. The special partner is not allowed to withdraw his capital as long as he continues to be a partner in the firm.
6. The death, insolvency or lunacy of a special partner does not dissolve the firm.
7. The special partner is allowed to enjoy his share of profits and can inspect the books of the firm.

3.11 DISSOLUTION OF PARTNERSHIP FIRM

The end of contractual relationship between all the partners is called dissolution of firm. The dissolution of a firm means discontinuous of its activities. But if one or more partners terminate their relationships with the firm and the rest of them continue the business under the same firm's name, it is not the dissolution of firm. Indian partnership act makes a clear distinction between the two.

Circumstances

3.11.1 The Dissolution of Partnership

Partnership will be dissolved under the following circumstances.

(1) Completion of duration or agreed period of partnership, if partnership existed for particular period.

(2) Completion of particular work or venture.

(3) Death of any partner or partners.

(4) Retirement of any partner or partners.

(5) Insolvency of any partner or partners.

3.11.2 Dissolution of the Firm

Firm will be dissolved under the following circumstances.

(1) If the partners agree to dissolve the firm.

(2) If all the partners except one becomes insolvent or retired or died.

(3) If the business of the firm is declared as illegal.

(4) If the court ordered to dissolve the partnership firm.

(5) In case of partnership at will, any partner can seek for dissolution of the firm by giving a prior notice of 14 days to all the partners of the firm.

3.11.3 Dissolution under an Order of the Court

Any partner of the firm may approach the court for dissolution of the firm under following circumstances :

(1)If a partner became insane.

(2) If a partner became disabled.

(3) If a partner is guilty of misconduct, which adversely affects the business.

(4) If a partner commits breach of agreement relating to business.

(5) If a partner transfers his share to the third party without the consent of other partners.

(6) If the firm is incurring losses continuously for long time.

(7) If there is any dispute, miunder standing between the partners.

(8) If there are any justifiable reasons that the court deems it fit to dissolve the firm.

Settlement of Accounts after Dissolution

On the dissolution of partnership, all the assets are realised and they are used to meet the outside liabilities of the firm. The order of preference to be followed while settling the accounts is

(1) to pay off outside liabilities.

(2) to pay off the loans of partners.

(3) to pay the partners' capital.

(4) Distribute the surplus among the partners in their profit sharing ratio, if any.

In the proceeds realisation of assets are less than the liabilities, the partners shall have to contribute the deficiency propertionately from their private properties. Under such circumstances if any partners is insolvent, the solvent partners have to bear the burden of insolvent in their capital contribution ratio.

3.12 Differences Between Partnership and Sole Trade Business

Sole Trade Business	Partnership Business
1. This is started by a single person.	1. To start this business, atleast two persons are required.
2. Maximum limit of members is also one.	2. Maximum limit of members should be 10 in banking and 20 in other business.
3. The investment is less.	3. The capital contribution is more.
4. It does not require any formality	4. It requires an agreement between partners.
5. Managerial skill is low. It is controlled and managed by one person only	5. Managerial talents are more. All partners can participate in the management.
6. Possibility of expansion of business is less	6. Possibility of expansion of business is more.
7. There is no scope for division of work	7. There is scope for division of work among partners.
8. More risk and single man should bear the whole risk.	8. Risk and loss shared by all the partners.
9. Motivation is more.	9. Motivation is less

10.Secrecy is more because the owner does reveal the business secrets.
11.There is possibility of taking prompt decisions.
12.The existence of business is uncertain. The death, insolvency of the owner leads to its dissolution.

10.Possibility of maintaining secrecy is less.
11.There is possibility of taking slow decisions.
12.The life of partnership is more. The insolvency, retirement, death of any partner does not affect the existance of the firm.

3.13 Difference between Hindu Undivided Family Business and Partnership Business :

Hindu Undivided Family Business

1. It is constituted by Hindu Law. Membership can be obtained only by birth or marriage with a male member of the family.
2. It is not dissolved because of death or insolvency of Karta or any other member.
3. Business is managed only by Karta, head of the family.
4. There is no ned of registration of firm.
5. The representative of the firm is only Karta.
6. Minor is also a partner of the firm. As soon as the child is born, becomes the member.
7. Every member of the family is guaranteed a minimum share in the profits of the firm. The ratio of share of profits and losses depends on the births and death.
8. It is governed by Hindu Law.
9. It has no separate legal entity from its members.
10. No maximum number of members all the family members are the members of the firm.
11. Karta has no need to prepare the books of accounts. No member can ask for the accounts.
12. The liability of Karta is unlimited. All the other members have limited liability.

Partnership Business

1. It is constituted by an agreement between the partners.
2. It may be dissolved because of death, insolvency or retirement of any partner
3. Every partner has the right to take part in the management of the business.
4. It is necessary to register the firm to attain some advantage.
5. Every partner is representative of the firm.
6. Minor is not a partner. Minor can be admitted for the benefits of the firm.
7. Partners share profits and losses on the agreed ratio.
8. It is governed under India Partnership Act, 1932.
9. It has a legal entity and identical to its partners in the eyes of law.
10. Maximum number of members is fixed. It is ten in banking business and twenty in any other business.
11. Any paprtner can inspect the accounts of the firm.
12. The liability of partners is unlimited. The person properties of partners are also liable in addition to their share in the business.

3.14 SUMMARY

1. Two or more persons carry on busienss jointly is partnership.
2. Liability of partner is unlimited, his liability is joint as well as several.
3. Registration of partnership firm is not compulsory.
4. The discontinuance of activities of partnership firm is known as the dissolution of firm.

3.15 TERMINOLOGY

1. Partners : Members in a partnership business are partners.
2. Partnership Deed : Agreement between partners.

3.16 SELF ASSESSMENT QUESTIONS

5 Marks Questions

1. Kinds of Partnership firms.
2. Liability of Partners
3. Minor Partner
4. Nominal Partner.
5. Partner by estoppel

10 Marks Questions

1. Characteristics of Partnership Business.
2. Contents on Partnership Deed.
3. Limited Partnership.
4. Registration of Partnership firm.
5. Rights and Duties of Partner.

20 Marks Questions

1. Define Partnership Business. Explain its advantages and Disadvantages.
2. Explain the kinds of partners.
3. Explain the dissolution of Partnership firm.
4. Distinguish sole trading concern and Partnership firm.

3.17 REFERENCE BOOKS

1. Industrial Organisation and Management - R.K.Sharma & Shashi K. Gupata
2. Industrial Organisation and Management - Y.K.Bhushan
3. Industrial Organisation and Management - Prof. K.V.Sivaiah & V.B.M.Das
4. Industrial Organisation and Management - M.C.Shukla

- Ch.Neela Krishnaveni
Lecturer in Commerce
Hindu College, Guntur.

LESSON - 4

JOINT STOCK COMPANY

4.0 OBJECTIVES

After going through this lesson student can know

- → Company, its characteristics.
- → Advantages and Disadvantages of Company.
- → Kinds of Companies.
- → Characteristics of Cooperatives.
- → Merits and Demerits of Cooperatives.

Structure

4.1 Introduction

4.2 Definition

4.3 Characteristics of a Company

4.4 Advantages of Company form of Organisation

4.5 Disadvantages of Company form of Organisation

4.6 Kinds of Companies

4.7 Distinction Between a Private Company and a Public Company.

4.8 Distinction between Partnership and Joint Stock Company

4.9 Previlages and Exemption of a Private Company

4.10 Co-operative Societies

4.10.1 Introduction

4.10.2 Definition

4.11 Characteriestics of Co-operative Organisation

4.12 Merits of Cooperatives

4.13 Demerits of Cooperatives

4.14 Types of Cooperatives

4.15 Distinction between a Cooperative Society and a Joint Stock Company

4.16 Summary

4.17 Terminology

4.18 Self Assessment Questions

4.20 Refernce Books

4.1 INTRODUCTION

The increased needs of modern industry and Commerce could not met by sole trading concern and partnership frrms. Therefore some other form of organisation was essential to accept the challenges of the modern industry.

Sole trading business and partnership firms are suffering with certain limitations such as limited resources, unlimited liability, limited existence etc. To overcome these drawbacks, and to carry on business on large scale, Joint stock companies came into existence.

Joint Stock Company Organisation started first in Italy in thirteenth Century. In India the first companies Act was passed in 1850. The principle of limited liability was introduced only in 1857. The application of Act was extended to Banking and Insurance companies in 1860. A comprehensive bill was passed in 1956. The firms incorporated under this Act are known as 'Companies'. The Companies Act, 1956 for the first time provided for a greater measure of government control over the formation and management of a Joint Stock Companies in India.

4.2 DEFINITION

According to James Stephenson, A company is 'an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit and loss arising thereform".

According to Prof. L.H.Haney "A Joint Stock Company is a voluntary association of individuals for profit, having a capital divided into transferable shares, the ownership of which is the condition of membership".

Chief Justice Marshall opines that "a corporation is an artificial being, invisible, intangible and existing only in contemplation of the law. Being a mere creation of law, possesses only the properties which the charter of its creation confers upon it either experessly or as incidental to its very existence".

According to section 3 of Indian Companies Act 1956, "A company means a company formed and registered under the Companies Act".

According to clause (ii) of section 3, "existing company means a company formed and registered under any of the previous company laws".

From the above definition, it is clear that a company is an association of persons who contribute money in the shape of shares and a company gets a legal entity and enjoys a permanent existence.

4.3 CHARACTERISTICS OF A COMPANY

Following are the characteristic features of a company.

(1) Association of Persons : A company is an association of persons with a common motive. A private company must have atleast two persons and a public limited company must have atleast seven persons to register it. Maximum number of members is 50 in case of private company and there is no maximum limit for the number of members in public company.

(2) Independent Corporate Existence : The distinguishing feature of a company is its independent corporate existence. Being a seperate legal entity, a company bears a corporate name. A company acts independently of its members. It acts almost like a human being. But company has no physical existence and it is an artificial person but not a natural person. It is capable of owning property, incurring debts, borrowing money, the company can sue and can be sued.

(3) Common Seal : Being an artificial person, a company cannot put its signature. The law requires every company to have a seal and get its name engraved on it. The seal of the company is affixed on all important documents and contracts as a token of signature. The directors must witness the affixation of the seal.

(4) Limited Liability: The liability of its shareholders is limited to the value of shares held by them. In case the company incurs huge debts, the shareholders are not personally liable for the debts.

(5) Transferability of Shares : The shares of a company can be transferred by its members without the consent of other members. Under articles of association, the company can put certain restrictions on the transfer of shares but it cannot stop.

(6) Perpetual Existence : The company has a permanent existence. The shareholder may come or may go but the company may go on forever. The lunacy, insolvency or death of the shareholders does not affect the continuity of the company. The shares of the company may change from time to time, but the continuity of the company is not at all affected.

(7) Seperation of Ownership and Management : The companies are managed by the Board of Directors. The ownership and management are in two seperate hands. A shareholder may like to invest money but do not have any right to participate in managemnt. Directors, who are the representatives of the shareholders have th right to manage the affairs of the company.

(8) Corporate Finance : A joint stock company raises large amount of funds. A large number of persons purchase the shares of the company and contribute to the capital of the company. Since, there is no limit on number of members in public companies, large amounts of sources can be raised from public.

(9) Centralised and Delegated Management : A joint stock company is an autonomous and self-governing body. The shareholder can not participate in day to day activites of the company. Hence they elect the Board of Directors in general body meting for managing the company. All important decisions are taken in a democratic way. The centralised management and democratic functioning brings in unity of action.

(10) Publication of Accounts : A joint stock company has to file annual statement with the Registrar of companies at the end of a financial year. The annual statement are open to every one for inspection in the office of Registrar.

4.4 ADVANTAGES OF COMPANY FORM OF ORGANISATION

(1) Large Resources : Joint stock companies are suitable for those business where large resources are required. A company can collect large sum of money by issuing shares and debentures.

(2) Limited Liability : The liability of members in a company is limited to the normal value of shares they held. If the shares are partly paid, then the liability of shareholders is only the unpaid value of the share. The limited liability encourages many persons to invest in shares of joint stock companies.

(3) Continuity of Existence : Company has a permanent existence. The members of a company may go on changing from time to time but it does not affect the continuity of a company. The continuity of a company is not only in the interests of members but also the beneficial for the society. The discontinuation of a company may cause wastage of resources and inconvenience to the consumers.

(4) Efficient Management : In company form of organisation, ownership and managemnt are in two hands. The large resources enables the company to attract and appoint talented persons for efficient managemnt of business functions. The efficient management helps the company to expand its activities.

(5) Economies of large Scale Operations : The increase in scale and size of business will result in economies in purchase of raw materials, cost of production, marketing and management etc.

6 Ability of changing its nature of Business : The needs and tastes of consumers are changing day to day. Hence every business is required to invest on research and development programmes. Joint stock companies can afford to invest money on research projects. It enable them to cope with ever changing business conditions.

(7) Risk Sharing : In company form of organisation, the contributors are large in number. So the risk is shared by them. As the risk and burden is shared by all the members, the company can take up the new ventures.

(8) Democratic Set up : Share holders come from all walks of life. Every individual has an opportunity to become a shareholder. Boards of Directors are elected by the members, will manage the company. So, the company management is based on democratic principle.

(9) Public Confidence : Public confidence can be easily gained by the company. Formation, managemnt and winding up of companies etc are well regulated by the act. Moreover, the company publishes its audited accounts and reports for public inspection.

(10) Social Benefits : There are several benefits to the society such as encouragement to the savings, motivation to invest, utilisation of natural resources, establishment of large industries and employment opportunities etc.

4.5 DISADVANTAGES OF COMPANY FORM OF ORGANISATION

1. Difficulty of Formation : Formation of a Company is both expensive and risky. The suitability of a particular business is to be decided first. Association of a number of persons is required to incorporate a company. A lot of legal formalities are to be followed at the time of its registration etc.

2. Seperation of Ownership and Management : Democratic management is not practical in company management. The owners, i.e., the shareholders spread all over the country and they cannot even attend the meeting. Therefore only a few of the shareholders always manage the company.

3. Lack of Secrecy : The management of companies remains in the hands of many persons. Everything is discussed in the meetings of the Board of Directors. The trade secrets cannot be maintained and the accounts and reports are published every year.

4. Delay in Decision - making : All the important decisions are taken either by Board of Directors or are referred to the general house. So Decision taking process is time consuming. Many business opportunities may be lost because of delay in decision making.

5. Concentration of Economic Power : Some members become directors in a number of companies and try to formulate policies which promote their own interests. Interlocking of directorship and establishment of subsidiary companies have facilitated concentration of economic power in the hands of a few business houses.

6. Lack of Initiative : The entire management is earned on by the salaries personnel. They may not have individual interest and initiative.

7. Group Rivalries : Various parties particpate in the administration of the company. Because of their own interests conflicts may develop. Disputes arise on salaries and bonus between directors and workers, on dividends between shareholders and directors and on loans and interest between creditors and Directors. These disputes affects the administration of the company.

8. Social Problems : The large scale business is carried on by companies. Gaint companies give rise to social evils of monopolies and concentration of economic power in a few hands. Companies are also responsible for evils such as weather pollution, drainage problem, shortage of houses, over population etc.

The company form of organisation possesses good and bad as two sides of a coin. By virtue of its merits, the company has been playing an important role in the economy of the country.

4.6 KINDS OF COMPANIES

KINDS OF COMPANIES

According to Incorporation	According to liability	On the basis of Ownership	According Nationality	According to transferability of Shares
1. Chartered Companies	1. Limited by Shares	1. Government Companies	1. Indian Companies	1. Private Companies
2. Statutory Companies	2. Limited by Guarantee	2. Holding Companies	2. Foreign Companies	2. Public Companies
3. Registered Companies	3. Unlimited Companies	3. Subsidiary Companies		

4.6.1 According to Incorporation

The companies may be categorised into three types according to their incorporation.

1. Chartered Companies : These companies are incorporated under Royal charter by the King. They are popular in England. The East India Compnay, the Chartered Bank of India etc.At present they are not found in India.

2. Statutory Companies : These companies are formed and registered under a special act of Parliament. The objects, powers, rights and responsibilities of these compnaies are clearly defined in the act. Examples are Reserve Bank of India, The Industrial Finance Corporation of India, the Life Insurance Corporation, etc.

3. Registered Companies : Any company formed and registered under the Indian Companies Act, 1956 or earlier Companies Act is called a Registered Company. The method of formation, management and liquidation are given under various clauses of this Act. These Registered Companies may be limited by shares, limited by guarantee or unlimited companies.

4.6.2 According to Liability

According to liability, the companies may categorised into three categories :

1. Companies Limited by shares : According to Sec 12(2)(a). A company having the liability of its members limited to the unpaid amount of the shared held by them. In case a member has paid the entire amount of his shares held by him, he will not be liable for any debts of the company. If the share are partly paid up, the members are liable to pay the balance on shares to the company. Most of the companies functioning in India are companies limited by shares.

2. Companies Limited by Guarantee : A company limited by guarantee may be formed with share capital or without share capital. These companies are also formed under the companies Act with a stipulation that the members are guaranteed to pay a certain amount of money. Trade or merchant associations, sports clubs, recreation clubs are examples of companies limited by guarantee.

3. Unlimited Companies : The companies registered without limiting the liability of members to the value of shares are called unlimited companies. All the members are liable to meet the liabilities of the company to an unlimited extent.

4.6.3 According to Nationality

According to the nationality companies are classified as :

1. Indian Companies : A company incorporated in India under the Companies Act, 1956, whether operating in India or outside, is called an Indian Company. They may be manufacturing companies, banking companies.

2. Foreign Companies : A company incorporated outside India but has a place of business in India through its branches or agencies in called a Foreign Company. Such company has to submit the necessary information to Registrar of Companies within 30 days of its incorporation.

1. Memorandum of Association and Articles of Association.
2. Address of Registered Office.
3. List of Directors.
4. Secretary of the Company
5. Names and addresses of persons who manage the business in India on behalf of Company.
6. Place, address of business centre in India.

4.6.4 On the Basis of Ownership

On the basis of ownership companies are classified as :

1. Government Companies : A company in which not less than 51% of shares in capital is held by central government, state or both Central and State governments is called Government Company. Examples are Bharat Electronics Limited, the Hindustan Aeronautics Limited, etc.

2. Holding Company : A holding company is a company which is controlling a subsidiary company.

A holding company is one which holds not less than 51% of the paid up capital of another company and which controls the composition of the Board of Directors of another company.

3. Subsidiary Company : The company which is controlled by a holding company is called a subsidiary company.

A Company is also a subsidiary of another company which is itself a subsidiary to another company For example 'A' company is a subsidiary of 'B' company and 'C' is subsidiary of 'A' company. Then 'C' company is also a subsidiary of 'B' company.

4.6.5 According to Transferability of Shares

On the basis of number of members and transferability of their shares the companies are classified as :

1. Private Company : According to sec 3(1)(iii) of the Act, " A private company is a company which by its Articles of Association (1) Restricts the right of members to transfer shares, if any. (2) Restricts the number of its members to 50 (the past and present employees of the company are not counted for this). (3) Prohibits any invitation to the public to subscribe for any shares and debentures of the company.

A private company can be formed with atleast two members. It may be limited by guarantee.

2. Public Companies : Sec 3(1)(iv) of the Indian Companies Act, 1956 says that all the companies other than private companies are called Public Companies. Public company means that public at large is interested in those companies. The membership of a public company is open to all persons capable of entering into a contract. A minimum of seven members are required to constitute a public company and to get it registered. There is no restriction on the maximum number of members. It can issue a prospectus for inviting people to purchase their shares.

4.7 Distinction between a Private and a Public Company

Both the Private and Public Companies are registered under Companies Act. They have certain similarities. However these are some differences between them.

Private Company	Public Company
1. Number of Members : At least two members are required to form. The maximum number should not exceed 50.	1. It can be started by seven persons and there is no maximum limit for members.
2. Commencement Business : Business can be started after getting the certificate of Incorporation.	2. Business can be started only after getting the certificate of commencement of business.
3. Issue of Prospectus: The company cannot issue prospectus for inviting public to purchase of its shares.	3. The Company must issue a prospectus or a statement in lieu of prospectus for inviting public for the purchase of its shares.
4. Transfer of Shares : The transfer of shares is genrally restricted by the articles.	4. Transfer of shares is freely allowed through some procedure for transfer has to be followed.
5. Kinds of Shares : It can issue equity, preference and deferred shares also.	5. It can issue equity and preference shares.

6. Share Warrants : It is prohibited in issuing share warrants.	6. It is allowed to issue share warrants.
7. Directors : There must be atleast two directors.	7. There must be atleast three directors.
8. Qualification Shares : Directors need not buy qualification shares to be elected as directors.	8. Directors have to subscribe qualification shares to become directors.
9. The remuneration should not exceed 11% of the net profits. In case of insufficient profits, maximum limit is restricted to Rs.50,000/-.	9. Remuneration to Directors : No restriction on the remuneration of directors.
10.Permission of central govt., is necessary for appointment of directors.	10 Appointment of Directors : No restrictions on appointment of directors.
11.Directors should submit their acceptance in writing to the Registrar.	11.Acceptance of Directors : No need of certificate of acceptance from Directors.
12.Every year 1/3 of the directors should retire by rotation.	12.Retirement of Directors : There is no such sale for the retirement of Directors.
13. It may prepare its own articles. If not, it can adopt Table-A of the Companies Act.	13.Articles of Asociation : It has to prepare and file with the registrar.
14.The company should conduct a statutory meeting within one year from the commencement of the business.	14.Statutory Meeting : No restriction. The company need not hold a statutory meeting.
15.The company has to submit its annual reports to the Registrar of the companies along with profits and loss account and Balance Sheet.	15.Annual Report : There is no need to attach the profit and loss account and balance sheet to the annual report which is submitted to the Registrar.
16.Only the word 'Limited' is used with the name of a Public Company.	16.Name of the Company : The word 'Pvt. Limited' must be added at the end of the name of the Company.

4.8 Distinction Between Partnership And Joint Stock Company

PARTNERSHIP	JOINT STOCK COMPANY
1. Status : A partnership concern is governed by Partnership Act, 1932.	1. Joint Stock Company is governed by the Companies Act, 1956.
2. Registration : Registration of Partnership is not compulsory.	2. The registration of a Company is compulsory.
3. Number of Members : Minimum number of members is 2. Maximum number is ten incase of banking and insurance business and twenty in case of any other business.	3. Minimum number of members in private company is 2. Maximum number is 50. In case of Public company, minimum number is 7 and no maximum limit on its members.

Partnership	Joint Stock Company
4. Legal Status : A partnership has no seperate legal entity apart from its members. Members can not enter into an agreement with the firm.	4. A company has a seperate legal entity members of the company can also enter into contract with the company.
5. Liability : The liability of partners is limited. The partners are jointly and seperate liable for the debts of the business.	5. The liability of shareholders is limited to the value of shares held by them. They are not personally liable for the obligations of the business.
6. Transfer of Shares : A partner can transfer his shares only with the consent of all other partners.	6. A shareholder may transfer or sell his shares in public limited companies. But some restriction are imposed on transfer of shares in case of private company.
7. Management and Control : A partnership is managed and controlled by the partners.	7. The company is managed by the Board of Directors, who are elected as representatives by the shareholders. But the members can not participate in day-to-day managment.
8. Statutory Obligations : There is no compulsion to maintain certain books of accounts, get the accounts audited and to publish them.	8. A company is required to maintain prescribed book and have a periodical audit.
9. Continuity : A partnership concern is dissolved on the death, insolvency of a partner.	9. The member may go on changing but the company will not be affected by the death or insolvency of a member.
10. Authority of members : A partner can bind the firm by his acts. There is an implied authority. A partner is an agent of the firm	10. A shareholder has no implied authority to bind the company. A shareholder cannot act on behalf of the company.
11. Winding up : A partnership concern can be dissolved easily. No legal formalities are required for its winding up.	11. A proper procedure should be followed. It is wound up only through court. If the court is satisfied that there is reasonable ground, then only it is to be wound up.

4.9 PREVILEGES AND EXEMPTIONS OF A PRIVATE COMPANY

A private limited company in confined to a group of persons. This company is given certain privileges and exemptions as compared to Public Company.

1. Just two members are enough to form a Private Company.
2. Only two directors are sufficient for the management.
3. It is not necessary to prepare and file a prospectus or a statement in lieu of prospectus.
4. There is no restriction of minimum subscription. It can directly allot the shares.
5. It can start the business immediately after getting the certificate of incorporation. And it has no need to wait for certificate of commencement.
6. A private company is not required to convene the statutory meeting and file the statutory report.
7. In the private company, the quorum for a meeting is just two

8. Directors need not buy qualification shares to be elected as directors.
9. The private company is exempted from publishign the mode of allotment of shares and filing with the registrar.
10. There is no necessity of seperate resolution for the appointment of every director.
11. There are no restrictions on appointment, remuneration and retirement of directors.

4.10 CO-OPERATIVE SOCIETIES

4.10.1 Introduction

In all forms of organisation, a sole trade, partnership or Joint Stock Company, the primary motive is to earn profits. The businessman wants to promote his own interest by all means including exploitation of consumers. The cooperative form of organisation is a democratic setup run by its members for serving their own interests.

The advent of factory system during 19th century, due to industrial revolution brought drastic changes in the growth of the economy of every country. As long as cottage industries dominated the production world. There was equitable distribution of wealth. But the industrial revolution started exploiting the poorer sections and few hands ruled all the economies during this period. The exploitation of consumers leads the way for birth of cooperatives for the first time in England and Germany.

Mr.Frederick Nicholson, a civil servant of Madras Government started co-operative movement in India. A committee was appointed by the Government of India to study and recommend the modalities to establish them. On the basis of its recommendations, cooperative societies Act was passed in 1904. Therefore the Co-operative movement took birth on the basic principle of "one for all and all for one". Profit making was not the objective of these societies but service was their main motto.

The Act came into force in 1904 and many defects were observed in the management and implementation of the cooperatives. To overcome these defects, the act was amended in 1912. Progress was made at later stages. The establishment and registration became a state subject after passing an Act by the Government of India in 1919.

4.10.2 Definition

Hubert Calvest say, "Co-operation is a form of organisation wherein persons voluntarily associate together as human beings on the basis of equality for the promotion of the economic interests of themselves".

Dr.H.N.Kunzen defines co-operatives as "Cooperative is Self help as well as mutual help. It is a joint enterprise of those who are not financially strong and cannot stand on their legs and therefore come together not with a view point to get profits but to overcome disability arising out of the want of adequate financial resources".

The Indian Cooperative societies Act, 1912 defines Cooperatives in section-4 as "a society which has its objectives the promotion of economic interests of its members in accordance with Cooperative principle".

4.11 CHARACTERISTICS OF CO-OPERATIVE ORGANISATION

1. **Voluntary Membership** : Every one is at liberty to enter or leave the Cooperative society as and when one likes. Nobody is compelled to joint a Cooperative society.

2. **Political and Religious Neutrality** : The membership of a Cooperative society is open to all irrespective of religion caste, creed, colour or political affiliation.

3. **Democratic Management** : The management of Cooperatives is always on democratic lines. All the members of a society elect a body of persons to conduct and control day-to-day working of the society. But the ultimate control lies with the members.

4. **Equal Voting Right to All** : In cooperative societies every member is given right to vote irrespective of his contribution towards the capital. All members have equal voice in the management of the society.

5. **Service Motive** : The primary objective Cooperative societies is to provide service to their members. The aim is not to earn profits.

6. **Capital** : The share capital contributed by the member is for the purpose of using it to the maximum advantage of all the members. Hence the members do not expect retain on capital employed.

7. **Distribution of Surplus** : The societies earn surplus from their services. This surplus is not divided according to capital contribution. A certain percentage is paid in the form of dividend on capital contributions. Some part of the surplus should be kept as reserve in the society and some part should be spent for general welfare of the members.

8. **Cash Trading** : Another feature of cooperative socieites is trading on 'cash basis'. Cash trading ensures economy for the Cooperatives. It eliminates bad debts and collection expenses.

9. **Government Regulations** : The Cooperative societies are to follow certain rules and regulations imposed by the government. And societies are registered and regulated under the Indian Cooperative Societies Act.

10. **Cooperative Education and Training** : The members of the society should be properly educated about the aims and objectives of the societies. Then the members may work for the success of the society.

11. **Limited Liability** : Liability of members of society is limited to the value of the shares held by them. They are not liable to the extent of their personal properties to meet the debts of the societies.

12. **Transfer of Shares** : Members should not transfer their shares to anybody.

13. **Tax Exemptions** : Societies are enjoying some tax exemptions and subsidise. These societies need not pay registration fee, income tax and stamp duty.

14. **Number of Members** : Minimum Ten members are required to establish Cooperative society. There is no maximum limit.

4.12 MERITS OF CO-OPERATIVES

1. **Open Membership** : The membership of Co-operative Societies is open to each and every person. Anybody wants to enjoy the fruits of a Co-operative society can joint it. Members may be limited in numbers but not discriminated in any way.

2. **Service Motto** : They are formed not for profits but for service. The societies try to promote the interest of this members. A feeling of Co-operation is developed among the members. Financial help is provided to the members at concessional rates and goods also provided at cheap rates.

3. **Supply of Goods at Cheaper Rates** : The societies purchase goods directly from producers and sell them to the member at cheap rates. Middlemen are eliminated in the process of distribution of goods and services.

4. **Democratic Management** : All the members are given equal participation in management of the Co-operative Society. Absence of profit maximisation and democratic management makes the society as the best service organisation to promote the public interest and social welfare.

5. **Low Managemnt Cost** : The Management of society is in the hands of the elected persons among the members. Members take active part in the working of the society. So the societies need.

6. **Surpluses shared by Members** : These societies sell goods to the memberrs on a nominal profit, and to non members at market rates. Some of the profits is distributed among the members and some part is used for welfare of the members.

7. **Perpetual Existence** : The society enjoy perpetual success on. the death or insolvency of members does not affect the life of the society.

8. **Check on other Business** : Cooperatives are working with service motive. When businessman try to exploit consumers by raising prices of their commodities, the cooperatives supply goods at reasonable prices. The Cooperatives are a check on other forms of organisation.

4.13 DEMERITS OF CO-OPERATIVES

1. **Lack of Capital** : The Cooperatives are started by economically weaker sections of the society. The resources are not enough to start large enterprises. They cannot undertake the production of goods for lack of resources. Moreover the return on capital is not attractive. Hence people hesitate to invest their money in these societies.

2. **Lack of Unity among the Members** : The participation of all the members of the society cannot be uniform. Domination of some members may lead to conflict among the members. Educated members may take the advantage of the uneducated members.

3. **Cash Trading** : The cash Trading business has both advantages and disadvantages. Private Traders facilitate Credit facilities to consumers. The societies sell goods at lower prices but absence of credit facilities forced them to go to private traders.

4. **Political Interference** : Many Co-operative societies are becoming platforms for politics and making some of the officers corrupt power and money. The societies are governed on political consideration rather than on business lines.

5. **Lack of Public Confidence** : The objectives of the societies are good but implementation and management are not proper. It leads to lack of public confidence on societies.

4.14 TYPES OF CO-OPERATIVES SOCIETIES

Various types of Co-operatives have been started with differnt motives. They are -

1. Consumer's Co-operatives : The consumer co-operative societies are started to help lower and middle class. These societies protect the weaker section from the profit thrust of the business men. The societies make bulk purchases directly from the producess and sell them to the members on retail basis. The society charges a small profit to meet the administrative costs.

In India, consumer co-operatives started under the control of Government. Government sells essential commodities to consumers at regulated prices through co-operative societies. They are working both in urban and rural areas.

2. Producers' Co-operatives: These societies are established for the benefit of small producers who find it difficult to collect various factors of production and also to face the marketing problems. The main purpose of them to provide necessary facilities to small producers and to improve their economic conditions. These societies are of two types.

a. Production co-operatives: The production of goods is undertaken by the members, sells them in the market. some of the profits retained in common pool and the remaining profits are distributed among the members.

b. Industrial service Co-operatives: These societies provide services to industries. These Co-operative societies purchase supply the raw material and other equipment to the members at reasonable prices. The output of member is marketed by the society. Individual members earn profits on their sales and also share the profits on an agreed ratio.

3. Marketing Co-operatives: These societies are associations of producers for selling their products at remunerative prices. This society undertakes to sell the products of the members by eliminating middle men. These societies also provide services like Grading, Warehousing, Transportation, Finance, Insurance etc., The goods are sold when the market is favourable.

4. Housing Co-operatives: The low and middle income people can not afford huge money to construct own houses. Housing co-operative societies help people to own their houses. The housing societies are of different types.

a. Some societies construct the houses and give them on small rent to the members. These societies are not popular because the fundamental aim of them is not satisfied i.e., instinct to own a house is not satisfied.

b. Some societies are helpful in arranging cheap plots and loans for the members. These societies are very popular in most of the states in India.

c. Another type of societies acquire land and construct houses themselves. The constructed houses are handed over to the members who pay the price in easy instalments over a longer peirod on low rate of interest.

In addition to the housing co-operatives many Government agencies like State Housing Boards help economically weaker sections of society in owning their houses.

5. Credit Co-operatives: The credit co-operatives are formed to give financial help to small farmers and other poor sections of the society. These societies are may be of two types.

a) Rural Credit Co-operative Societies : These societies provide short term loans at low rate interest. The object of these societies is "better farming and better living".

b) Urban Credit Co-operative Societies : The aim of these societies is to help small traders, workers, artisans and otehr middle class people.

6. Coopeartive Farming Societies :

Coopeartive farming societies are voluntary associations of farmers framed to reap the benefit of large scale farming on scientific line. These societies helps to small land holders and cultivators to use advanced farm technology to raise their produce and to raise their economic position.

The farming co-operative may be of the following types :

a) Co-operative better Farming Societies : Members cultivate their lands independently. The society provides only services and the members pay service charges to the society.

b) Co-operative joint Farming Societies : The land of the members pooled in these societies. Members are paid wages for their work. The profits are divided according to the wages earned by the members.

c) Tenant Farming Societies : These societies are formed to help the tenants. The society acquires land on lease hold basis and distributes among the members. The society also arranges financial help and also various inputs like seeds, fertilizers etc. The members pay rent for utilising land, the produce to the tenants, but not to the society.

d) Collective Farming Societies : The land is owned by the society and the members work collectively on the land. No member has independent ownership on land. Daily wages are paid for their labour and profits are distributed among the members on the ratio of their wages.

4.15 Distinction Between a Company and Co-operative Society

JOINT STOCK COMPANY	CO-OPERATIVE SOCIETY
1. Registration Companies are registered under Companies Act, 1956	1. Societies are registerd under either Coopertive Society Act, 1912 or State Co-operative Acts.
2. Number of Members A Private company can start with a minimum of two members and maximum of fifty. Whereas in a public company minimum number is seven and there is no maximum.	2. A Society can start with minimum of ten and there is no maximum limit.
3. Object The main object is earning profits.	3. The main object of the Sciety is to provide service to its members.
4. Share Capital There is a chance of huge capital. It is desirable and possible.	4. It is not desirable and possible of having huge capital.
5. Voting Right There is right to vote for each and every share.	5. There is one vote to one member.
6. Transfer of Shares The members can transfer their shares to others.	6. The members cannot transfer their shares to others.

7. Payment of Registration fee etc. Company has to pay registration fee, stamp duty and Income Tax.	7. Society need not pay registration fee, stamp duty and income tax.
8. Withdrawl of Capital Shareholder cannot withdraw his capital from the company, but can get back his capital by selling his shares in the market.	8. Member can withdraw his capital from the society if he desires by giving due notice to the society.
9. Ownership and Control Elected board of directors manages and controls the affairs of company. Ownership and managemnt are different.	9. Both Ownership and managemnt are one and the same in the societies.
10.Issues of New Shares If new shares are issued, they are offered to existing shareholders and if they do not accept, they can be issue to the public	10.If capital is increased, new shares are issued to the public.
11. Distribution of Profits Profits are distirbuted among the shareholders on the basis of their share capital.	11.Surplus is distributed among the members on the basis of their dealing with the society.

4.16 SUMMARY

1. A company organisation is suitable for business enterprises which are engaged in large scale production.
2. Companies are classified on the basis of incorporation, on the basis of liability, on the basis of ownership, on the basis of nationality, on the basis of transferability of shares.
3. Co-operatives are formed on the principle of service.
4. Various Co-operative Societies are formed not for making profits but to privode service to their members.

4.17 TERMINOLOGY

1. Common Seal	:	Common seal of the company acts as its official signature.
2. Chartered Company of the State.	:	A company created by the special charter of the King or Head
3. Limited Liability	:	The liability of the members of the company is limited to the extent of face value of shares held by them.
4. Limited by Shares	:	Liability of the members of the Company limited to the unpaid amount of shares held by them.
5. Co-operative	:	Co-operative movement took birth on the principle of ‘one for all and all for one’.

4.18 SELF ASSESSMENT QUESTIONS

5 Marks Questions

1. Chartered Companies.
2. Statutory Companies.
3. Private Company.
4. Company Limited by Shares.
5. Government Company.
6. Co-operatives

10 Marks Questions

1. Explain the characteristics of Joint Stock Company.
2. Explain the previlages enjoyed by a private company.
3. Explain the characteristics of Co-operative form of organisation.
4. Explain the difference between a private and public company.

20 Marks Questions

1. What are the merits and demerits of Joint Stock Company.
2. Define Company, What are various kinds of Companies.
3. What is Co-operative Society? Explain its merits and demerits.
4. Distinguish Partnership and Joint Stock Company.

4.20 REFERNCE BOOKS

1. Industrial Organisation and Management Y.K.Bhushan
2. Industrial Organisation and Management M.C.Shukla
3. Industrial Organisation and Management Jagadish Prakash
4. Industrial Organisation and Management V.Surendar

- Ch.Neela Krishnaveni
Lecturer in Commerce
Hindu College, Guntur.

LESSON - 5

INCORPORATION OF A COMPANY

5.0 OBJECTIVES

After going through this lesson student can know about

→ Promters

→ Necessary documents required for formation of a Company

→ MOA

→ AOA

→ Prospectus

→ Commencement of Business

Structure

5.1 FORMATION OF A COMPANY - DOCUMENTATION

A company like any other business requires a process to be followed. A number of formalities have to be completed before a unit can come into existence. It is easy to start soletrade and partnership concerns but a Joint Stock Company requires a lengthy process.

According to L.H.Haney, “Promotion may be defined as the process of organising and planning the finance of a business enterprise under the Corporate form.”

Guthmann and Dougal consider that “promotion starts with the conception of the idea from which the business is to evolve and continue down to the point at which the business if fully ready to begin operations as a going concern”.

5.2 STAGES OF PROMOTION

There are four stages in the promotion of a Joint Stock Company. They are :

1. Discovery of an Idea.
2. Detailed Investigation.
3. Assembling the Requiremnts
4. Financing Proposition.

1. Discovery of an Idea : The term promotion is associated mainly with the thinking aspect of the persons actively engaged in the formation of a company. A person may visualise that there are opportunities for a particular type of business. The idea may be a new area or more profitable venture in an existing line of business. He develops this idea with the help of technical experts in that field.

The promoters are always engaged in hunting after business opportunities and possibilites. They are always in search of new business opportunities, new manufacturing processes, new innovations and so on.

2. Detailed Investigation : At the second stage various factors relating to that business are studied from a practical point of view. The promoters will estimate the total demand for the product. Then he will think of arranging finances for the venture. The availability of power, labour, raw materials and machinery is also considered. The cost structure of the product is analysed to find the profitability of the venture. The promoter will collect the opinions from technical expert, economists, market analysts, managerial advisors etc., and he can take the final decision.

3. Assembling the Requirements : After making sure that the decision is practical and profitable, the promoter proceeds for further requirements. The promoter selects the factory site, decides about the plant and machinery and suppliers of raw materials, appointment of staff and expertise managerial personnel, mobilising capital, and getting necessary licences from government etc.

4. Financing the Proposition : The promoter decides about the capital structure of the company. The requiremnts of finances are estimated first. The sources of finances are determined. The financial requirements of short and long periods are estimated seperately. Amount of share cpaital and type of shares to be issued, mode of issuing shares and debentures, the nature of loans are finalised.

5.3 PROMOTERS

A promoter conceives an idea for setting up a particular business at a given place and performs various necessary formalities to start a company. Professionals like counsels, solicitors, accountants, etc., assist the promoter in fulfilling various legal formalities.

Justice C.J.Cokburn says, “A promoter in one who undertakes to form a company with refernce to given object and takes the necessary steps to accomplish that purpose”.

Arthur Dewing says “A promoter is the person conscious of the possibility of transforming an idea into a business capable of yielding a profit, who brings together various persons concerned and who finally superintendents the various steps necessary to bring the new business into existence”.

5.3.1 Characteristics of a Promoter

The above given definitions bring out the following characteristics or features of a promoter :

1. A promoter conceives an idea for the setting up a business.
2. He makes preliminary investigvations and ensures about the future prospects of the business.
3. He brings together various persons who agree to associate with him and share the business responsibilities.
4. He prepares various documents and gets the company incorporated.
5. He raises the required finances and gets the company going.

5.3.2 Kinds of Promoters

The promoters may be of the following types :

1. Professional Promoters: These are th persons who specialise in promotion of companies. They hand over the companies to shareholders when the business starts. In India, there is lack of professional promoters.

2. Occasional Promoters: They take up the promotion of some company and then go to their earlier profession. For instance, engineers, lawyers etc., may float some companies.

3. Financial Promoters: They generally take up this work when financial environment is favourable at the time.

4. Managing Agents as Promoters: In India, Managing Agents played an important role in promoting new companies.

5.3.3 Remuneration of Promoters

The promoters undertake the work of promoting new companies and bear the initial risks. They do this work with a view to get some gains for them. In India, promoters try to become managing directors of the companies promoted by them; so they do not charge anything separately for this work. In other cases, the promoters may be remunerated in the following ways:

1. They may be given lump sum amount for thier services. They may also be allotted shares or debentures too.
2. The promoters may purchase some property and then transfer it to the company at inflated

rates and pocket the difference.

3. They may be given some commission on the purchase price of business taken over by the company.

5.3.4 Legal Position of Promoter

The company law has not given any legal status to pormoters. He stands in a fiduciary position. The promoter moulds and creates the company and under his supervision it comes into existence. It is the duty of the promoter to get maximum benefits for the company. He should not get secret profits from the company.

5.4 FORMATION OF A COMPANY

Legal aspect of promotion deals with the formalities required for setting up a business. The formalities are linked to the form of organisation of the enterprise and its scale of operations.

A Joint Stock Company requires a number of legal formalities before it can be set up. It has to deal with the following aspects :

A. Registration or Incorporation

B. Capital Subscription

C. Commencement of Business

5.4.1 Registration or Incorporation

A company being an artificial entity comes into existence only after its registration with the Registrar of Companies. A number of formalities have to be completed before a request is made to the Registrar for its registration. After ensuring that all necessary documents are filed, the Registrar of companies issues a certificate of Incorporation. With this certificate, the company becomes a separate legal entity.

Steps for Incorporating a Company

Before getting a company registered, a number of steps have to be take up :

1. Appliication for approval of name
2. Preparation of Memorandum of Association
3. Preparation of Articles of Association.
4. The consent of first directors.
5. Copies of preliminary agreements, memorandum and Articles of Association.
6. Address of a registered office and its information.
7. Names of first directors in its Articles, their particulars.
8. A statutory declaration that all legal requirements for registration have been complied with is also filed with the Registrar at the time of registration. The declaration must be signed by an advocate of Supreme Court or High Court, or an attorney or pleader of High Court or a practising Charactered Accountant.
9. **Payment of Fees** : At the time of registration, prescribed registration fees and filing fee for each document filed for registration are to be paid at the Registrar's office.
10. **Incorporation Certificate :** When all the required documents are filed with the Registrar along

with the requisite fees, a scrutiny is made. When all documents are found in order, the Registrar will enter the name of the company in the Registrar of Companies and issues a Certificate of Incorporation. The date mentioned in the certificate is the date of incorporation of the company.

5.4.2 Capital Subscription

After going through the incorporation formalities, the next stage will be to raise funds. A public company cannot commence business unless minimum subscription as stated in the prospectus has been subscribed. The amount stated for allotment should be duly recieved in cash and allotment has been made properly.

5.4.3 Commencement of Business

A private company is not required to get a Certificate of Commencement. It can straightway start work after getting Certificate of Incoporation. A company has to complete certain formalities before it can get the Certificate of Commencement. The company will file the following documents with the Registrar.

1. A declaration that a prospectus or a statement in lieu of prospectus has been filed with the Registrar of Companies.
2. A declaration that shares payable in cash equivalent to minimum subscription have been allotted.
3. A declaration that directors have taken up their qualification shares and have paid application and allotment money in the same proportion as others.
4. A statement that no money is liable to become refundable to the applicants by reason of failure to apply for or to obtain permission for shares or debentures to be dealt in on any recognised stock exchange.
5. The secretary of the company or a director files a statutory declaration that the requirements relating to the commencemnt of business have been duly complied with.

The Registrar will satisfy himself that all the documents are in order and all the lgal formalities have been completed. He will issue a Certificate of Commencemnt of business entitling th company to start its business from the date mentioned in the certificate. The process of company formation comes to an end with the iissue of this certificate.

5.5 IMPORTANT DOCUMENTS ISSUED BY A COMPANY

1. Memoradum of Association
2. Articles of Association
3. Prospectus

5.5.1 Memorandum of Association

The Memorandum of Association is the constitution of the company and provides the foundation on which its structure is built. It is the principal document of the company and no company can be registered without the memorandum of association. The memorandum of association is the company's charter and defined the limitations of its powers. Its purpose is to enable shareholders, creditors and those who deal with the company, to know what is its permitted range of enterprise.

Purpose

The main purpose of the memorandum is to explain the scope of activities of the company. The prospective shareholders know the areas where company will invest their money and the risk they are taking in investing the money. The outsiders will understand the limits of the working of the company and their dealings with it should remain within the prescribed scope.

Clauses of Memorandum

The memorandum of association contains the following clauses :

1. The Name Clause. A company being a separate legal entity must have a name. A company may select any name which does not resemble the name of any other company and should not be objectionable in the opinion of the government. The word 'limited' must be used by the Private Company. These words are used to ensure that all persons dealing with the company should know that the liability of its members is limited. If the company has a name which is undesirable or resembles the name of any other existing company, this name can be changed by passing an ordinary resolution.

2. Registered Office Clause. Every company should have a registered office, the address of which should be communicated to the Registrar of Companies. The place of registered office can be intimated to the Registrar within 30 days of incorporation or commencement of business, whichever is earlier.

A company can shift its registered office from one place to another in the same town with an intimation to the Registrar. But if the company wants to shift its reigstered office from one town to another town in the same state, a special resolution is required to be passed. If the office is to be shifted from one state to another state it involves alteration in the memorandum.

3. Object Clause. This is one of the important clauses of the Memorandum of Association. It determines the rights and powers of the company and also defines its sphere of activities. The object clause should be decided carefully because it is difficult to alter this clause later on. No activity can be taken up by the company which is not mentioned in the object clause.

The Companies (Amendment) Act, 1965 requires that in case of companies formed after this amendment, the memorandum must state separately (a) main objects, and (b) other objects.

4. Liability Clause. This clause states that the liability of the members is limited to the value of shares held by them. The liability of the members may be limited by guarantee. It also states the amount which every member will undertake to contribute to the assets of the company in the event of its winding up.

5. Capital Clause. The clause states the total capital of the proposed company. The division of capital into equity share capital and preference share capital should also be mentioned. The number of shares in each category and their value should be given.

6. Association Clause. This clause contains the names of signatories to the memorandum of association. The memorandum must be signed by atleast seven persons in the case of a public limited company and by at least two persons in case of private limited company. Each subscriber must take at least one share in the company. The signature of subscribers are attested by at least one witness each. The full addresses and occupations of subscribers and the witnesses are also given.

5.5.2 Alteration of the Memorandum of Association

Companies are not allowed to make alterations in their Memorandum in any manner they like. The Act has prescribed the procedures and the extent of alternation of different clauses of Memorandum.

1. Name Clause: With the written permission of central government and by passing a special resolution the name of company can be changed anytime. If a company is registered with such a name by inadvertance, which is identical or nearly similar to the name of an existing company then the new company can change its name by an ordinary resolution and with the prior approval of the central government. Whenever the name of company is changed the same must be informed to the Registrar.

2. Domicile Clause : Alteration of domicile clause means shifting of company's registered office from one place to another place, which may be :

i. To shift the registered office from one locality to another locality in the same town an ordinary resolution should be passed and a notice of change of location given to the Registrar.

ii. To shift the registered office form one town to another town in the same state - a special resolution should be passed and notice of change of location should be given to the Registrar.

iii. To shift the registered office from one state to another state - a special resolution should be passed and confirmation of the Company Law Board should be obtained. Finally the confirmation so obtained and the altered Memorandum of Association must be filed with the Registrar of both the states.

3. Objects Clause : In fact, the objects of the company cannot be altered. However, to attain the original object, an alteration is permitted. The alteration should be:

i. to carry on its business more economically or efficiently.

ii. to attain its main purpose by new or improved means.

iii. to enlarge the area of its operation.

iv. to carry on some other business in combination with the eixsting one.

v. to sell the whole or a part of the company's property.

vi. to amalgamate with any other company or association.

vii. to restrict or abandon any of the objects specified in the memorandum.

For the purpose of altering the objects clause a special resolution should be passed and confirmation of the Company Law Board should be obtained and and altered Memorandum should be filed with the Registrar.

4. The Liability Clause. The liability of the shareholders cannot be altered as unlimited in case of companies limited by shares. But the directors liability can be made as unlimited. A special resolution is required to alter the liability clause.

5. The Capital Clause : The alteration of capital clause may be in any of the following ways:

i. Alteration of the Share capital

ii. Reduction of share capital.

iii.Variation of the rights of the shareholders.

iv.Rearrangement of share capital by passing resolution in general meeting.

6. The Association Clause : It is not subject to alteration.

5.5.3 Articles of Association

The Articles of Association contains the rules and regulations for the internal management of the company. Many procedural matters relating to the day-to-day administration of the company are mentioned in the Articles. The Articles regulate the relationship between the company and the members.

The Articles of Association is the second most important document to be prepared and filed compulsorily by private companies, companies limited by guarantee, and unlimited companies for the purpose of registration whereas by an option is given to the public companies who may frame their own Articles of Association or may adopt “Table-A” of the Companies Act as their Articles.

The Articles should be printed, divided into paragraphs and signed by each of the subscribers to the Memorandum in the presence of at least one witness.

Contents of Articles : Usually on the following matters the Articles frame the rules.

1. The extent to which ‘Table-A’ applies.

2. Different classes of shares along with their rights.

3. Issue of shares and allotment of shares.

4. Issue of share certificates and share warrants.

5. Lien on shares.

6. Forfeiture of shares and the re-issue of forfeited shares.

7. Transfer and transmission of shares.

8. Calls on shares.

9. Conversion of shares into stock.

10.Underwriter’s commission on shares and debentures.

11.Preliminary contracts and their adoption.

12.Reorganisation and consolidation of share capital.

13.Alteration of share capital.

14.Borrowing powers.

15.Different kinds of general meetings.

16.Voting rights of members, proxies and polls.

17.Dividends.

18.Appointment, powers, duties etc of Directors.

19.Common seal of the Company

20.Books of account and audit, Auditors.

21.Capitalisation of profits.

22.Board meeting resolutions.

23.Appointment, powers, duties etc of managing directors, manager, secretary if any.

24. Winding up and such other provisions as may be necessary for the routine conduct of the company's business.

Alteration of Articles of Association

There are no regulations so far as alteation of Articles is concerned. The Articles cna be freely altered at any time. For the purpose of alteration the following steps should be taken:

a. A special resolution should be passed.

b. A copy of the special resolution should be filed with the Registrar within 30 days of passing the resolution, and

c. The altered printed copy of the Article must be filed with the Registrar within 3 months of passing the special resolution.

5.5.4 Difference between Memorandum of Association and Articles of Association

Articles of Association

The articles contain bye-laws for the day-to-day working of the company. Articles are framed in the orbit of the memorandum of association.

Public companies may not have their own articles, but can adopt Table A of Schddule I as its articles. Private companies, companies limited by guarantee and unlimited companies must have their own articles.

The articles of association are subordinate to the memorandum and Companies Act and cannot contain anything contrary to both.

Anything done beyond the scope of the articles will not be void and it can be ratified by passing a special resolution.

It defines relationship between company and the members and among members themselves.

Alteration of articles is not difficult. It can be altered by passing special resolution.

5.5.5 Prospectus

Prospectus intends to inform to inviting public to subscribe for its shares and debentures. It gives the details of the company with regard to the amount of shares or debentures issued, rights of the shareholders, the property purchased, directors, managing directors, auditors, bankers etc. It creates confidence in the minds of the public.

Contents of Prospectus : All the necessary details required for an investor to decide about his investment in a company are given in the prospectus.

The contents of prospectus are given below :

1. Detials of debentures if issued.

2. Rights of different classes of share holders.

3. Particulars of directors and managing director with regard to the remuneration, power etc.

4. Details of pre-incorporation expenses.

5. Details of minimum subscription.

6. Opening and closing date of subscription list.

It should be noted that every promoter director or any other person will be responsible for marketing any false statement in the prospectus.

5.5.6 Allotment of Shares

The dates of acceptance of applications for the allotment of shares are decided in advance and advertised in the newspapers. Accordingly, after the expiry of the last date, the directors hold a meeting, scruitinise the applications with the number of shares and then allotment is made. If the applications are less than the number of shares, the shares are allotted in full to all the applicants. In case, the applications are in excess, the shares are allotted on prorata basis. the excess applications are rejected and the amount thereon is refunded to the applicants or the surplus amount is adjusted to allotment money due. After the allotment, the applicants become authorised shareholders.

5.5.7 Minimum Subscription

Some minimum amount is required to purchase fixed assets and to meet the preliminary expenses and working capital of the company. Without this amount, it is not possible to establish the company. Thus, the least amount required to set up the company and keep it going, is called “Minimum Subscription. “A Company should collect this amount from the public necessarily. Otherwise, it is not allowed to allot shares. This amount should necessarily be mentioned in the prospectus. The minimum subscription is fixed covering the following items.

Items Constituting Minimum Subscription

1. Purchase of fixed assets viz., Land, Buildings, Plant and Machinery, Furniture, Vehicles, etc.

2. Expenses incurred in connection with Incorporation viz., Registration Fee, Stamp duty, Stationery etc.

3. Preliminary expenses, viz., commission and brokerage payable to underwriters etc.

4. Working capital expenses, viz., Raw materials, Wages, Fuel, Transport charges, etc.

5. Any other expenditure towards promotion and management of the company.

The minimum subscription should be raised from the public within 120 days from the date of issue of prospectus. If the company fails to do so, it is deemed that the public is not interested in the promotion of the company. In such a case, the whole amount collected so far should be refunded to the applicants within 10 days without interest. If it fails to do so, the persons authorising the company are punishable under companies Act. Thereafter, the directors are liable to repay the money with an interest of 6 per cent per annum.

5.5.8 Preliminary Expenses

A company requires a lot of expenditure for its formation. These expenses are known as preliminary expenses. They include promotional expenses, registration charges, expenses for collection of capital etc. Since these expenses are indispensable for the commencement of the concern, these are also known as "Commencement Expenses." The following expenses are regarded as preliminary expenses:

1. Registation fee and cost of applications for the incorporation of the company with the Registrar.
2. Preparation and printing charges of Memorandum and Articles of Association.
3. Expenses towards contracts with suppliers, transport agents, importers, exporters, bankers, brokers, etc.
4. Fees payable to values for assessing the value of assets.
5. Cost of stationery and printing relating to debentures, share certificates, letters of allotment etc.
6. Purchase of account books and office equipment such as day books, ledgers, stationery for office use and preparation of common seal.
7. Cost of preparation, printing and distribution of prospectus.
8. In case an existing company is acquired, payment of remuneration is made to the business accountant for assessing the profits.

5.6 SUMMARY

1. Every company should be registered with the Registrar of Companies. it cannot carry on business without registration.
2. Important documents should be filed are Memorandum of Association, Articles of Association Prospespectus, Declaration of Directors etc.
3. Registration fee should be paid.
4. The Registrar scrutinises the documents and if found satisfactory, will issue the certificate of incorporation.

5.7 TERMINOLOGY

1. Promoter - A person by which a company is brought is to existence.
2. M.O.A. - Memorandum of Association is the constitution of the Company. It defines the scope of Companies activities.

3. A.O.A. - Articles of Association consists of rules and regulations for the enternal manage ment of the Company. It gives the Objectives of the Company.

4. Prospectus - An invitation to the public to subscribe the shares and debentures of the Company

5.8 SELF ASSESSMENT QUESTIONS

Five Marks Questions

1. Describe the characteristics of a Promoter.
2. What are the various documents required for incorporation of a Company.
3. Discuss Object Clause.
4. Explain Preliminary expenses.
5. Explain statement in lieu of prospectus.

Ten Marks Questions

1. What is the procedure followed for altering object clause.
2. What are the contents of Articles of Association.
3. Explain the differnece between memorandum of Association and Articles of Association.
4. Discuss the need for issuing Prospectus.

Twenty Marks Questions

1. Explaint he various formalities in the formation of a Company.
2. What is Memorandum of Association? Explain the procedure followed for the alteration of its clauses.
3. Explain the documents required at the time of formation of a Company.
4. What is meant by Prospectus. Discuss the contents of Prospectus.

5.9 REFERENCE BOOKS

1. Industrial Organisation & Management R.K.Sharma & Shashi K.Gupta
2. Industrial Organisation & Management Y.K.Bhushan
3. Industrial Organisation & Management Prof.K.V.Sivaiah & VBM Das
4. Industrial Organisation & Management M.C.Shukla

- Ch.Neela Krishnaveni
Lecturer in Commerce
Hindu College, Guntur.

LESSON 6

INDUSTRIAL STRUCTURE

6.0 Objectives

A careful study of this chapter will enable you to understand the

1. Public Sector - Meaning, Features, Objectives, Advantages, Disadvantages, Forms.
2. Private Sector - Meaning, Features, Advantages, Disadvantages.
3. Joint Sector - Factors, Features, Advantages, Limitations.
4. Co-Operative Sector - Features, Weaknesses.

Structure

6.1 Introduction

Various industrial policies adopted after independence aimed at equal role for Public and Private sectors. Some areas of strategic importance were reversed for Public sector while others were demarcated both for Public as well as Private sectors. Besides these two sectors there are Joint sector and Co-operative sectors also.

6.2 Public Sector

Public enterprises as a form of business organisation have gained importance only in recent times. During twentieth century, out break of two world wars, depression in many countries and social evils of Industrial Revolution of earlier times compelled state governments to participate in planning and developing industrial structure of their countries. At present, Public sector enterprises are engaged in manufacturing, trading as well as service activities.

State enterprise is an undertaking owned and controlled by the local or state or central government. Either whole or most of the enterprise is to provide goods and services to the public at a reasonable rate. Though profit earning is not excluded but their primary objective is social service.

6.2.1 Definitations

"Public Enterprise means state ownership and operation of industrial, agricultural, financial and commercial under-taking".

—— A.H.Hansen.

"The industrial, commercial and economic activities, carried on by the central or by a state government and in each case either soley or in association with Private enterprise so long it is managed by self-contained management".

—— S.S.Khera.

"Public enterprises are autonomous or semi-autonomous corporations and companies established owned and controlled by the state and engaged in industrial and commercial activities".

—— N.N.Mallya.

6.2.2 Charecteristics of Public Enterprises

The following are the main characteristics of state enterprises.

1. Financed by Government: - Public enterprises are financed by the Government. They are either owned by the Government or majority shares are held by the Government.

2. Government Management: - Public enterprises are managed by the Government. In some cases government has started enterprises under its own department. In other cases government nominates persons to manage the undertaking. Even autonomous bodies are directly and indirectly controlled by the Governments departments.

3. Financial Independence: - Though investments in Government undertakings are done by the government, they become financially independent. These enterprises arrange and

manage their own finances. An element of profitability is also considered while pricing their products. It has helped the enterprises to finance their growth themselves.

4. Useful for Various Sectors: - State enterprises do not serve a particular section of the society, but they are useful for everybody. They serve all sectors of the economy.
5. Monopoly Enterprises: - In most of the cases Public enterprises are monopoly enterprises. Private sector is not allowed to enter that line. Railways, energy, Production and distribution, coal mining etc., are all monopoly undertakings.
6. Public Services: - The Primary aim of state enterprises is to provide service to the society. These enterprises are stated with a service motive.
7. Direct Channels for Using Foreign Money: - Most of the government aid is utilised through Public enterprises. Financial and technical assistance received from industrially advanced countries is used in Public enterprises.
8. Helpful in Implementing Government Plans: - Economic Policies and plans of the Government are implemented through Public enterprises.
9. Autonomous or Semi Autonomous Bodies: - In some cases they work under the control of Government departments and in other cases, they are established under official statutus and under companies act.

6.2.3 Objectives of Public Enterprises

The Primary objective of the state enterprises is to serve the people and help in creating an environment of industrial activity.

1. Helping All-round Industrialisation: - Government wants to develop all types of industries, whether they are profitable or not. It helps in all-round industrialisation of the country.

2. Establishing Enterprises Requiring Heavy Investment: - Some undertakings need heavy investment and their gestation period may also be longer. Private industrialists cannot afford to make huge investments. Government has large finances and it enters those fields where Private entrepreneurs cannot afford to invest. Incase of railways, ship-building, energy producing concerns, very huge investments are required and it is beyond the means of private investors to enter these fields. So, Government enters these fields and establishes its own undertakings.

3. To Provide Necessities: - Government undertakes to provide various necessities like electricity, coal, gas, transport and water facilities to the people. The aim is not only to provide these basic amenities but they should also be provided at cheap rates. Private sector cannot be relied upon to provide those services. So, public utilities are provided by government undertakings.

4. For Avoiding Concentration of Economic Power: - If private sector is given a free hand industrialisation will lead to exploitation of consumers. Private entrepreneurs will try to maximise their profits. It will ultimately lead to concentration of economic power in fewer hands. The existence of Public sector will be a check on the Private sector.

5. For Balanced Economic Growth: - The aim of industrialisation is to develop all industries necessary for the country and various regions of the country should be equally developed. Private entrepreneurs will aim more at profitability and not on balanced economic and regional

development. Public sector takes up all those industries where private investors do not invest. The development of different areas is also considered by the Government while setting up new units.

6. To Run Monopoly Sectors: - Some industries like defence, nuclear energy etc., are to be developed only in Public sector and cannot be left for the Private sector.

7. Exploitation of Natural Resources: - State enterprises are necessary for exploiting natural resources. For example Oil and Natural Gas Commission in India spends huge amount for finding out new sources of oil and gas.

8. To Increase Government Resources: - Some of the state enterprises are run on commercial lines. These concerns can provide resources to the Government through their surpluses.

9. To Provide Healthy Competition to the Private Sector: - State enterprises are a check on the Private sector. Private sector will have to provide goods and services on a competitive basis. If there is no state enterprise then Public will be at the mercy of the Private Sector. Public sector aims at providing goods and services at reasonable rates. So, Private sector will also sell goods on the same rates. So, state enterprises provide healthy competition to the Private sector.

6.2.4 Advantages of Public Enterprises

1. Speeding up Industrialisation: - Developing countries like India need huge investment on providing infra-structural facilities and developing basic industries like iron and steel, coal, oil, telecommunications etc. These investments are essential for speeding up the pace of industrialisation.
2. Planned Growth: - Whenever a unit is setup in Public sector, government will enter only those areas where demand for products or services will be more but supply may be less. This will help in planned and balanced growth of all areas.
3. Balanced Regional Growth: - Government prefers to set up units in backward areas so that people of those areas are able to get employment opportunities. This is essential for having balanced development of all areas.
4. Balancing Demand and Supply: - Private investors try to exploit consumers by creating artificial scarcity of goods with the presence of Public sector units this tendency will be curved. Moreover, Public sector units will be setup in those industries where demand for goods is more than the supply. This will help in balancing the demand and supply position.
5. Helping in Social Change: - Public sector units can be used for furthering the welfare of people. There will not be any exploitation of workers and consumers. The production patterns will be determined by the requirements of the society and not the profit earning urge. This will help in bringing a new social order which is helpful for the progress of the country.
6. Taking over Sick Units: - Sometimes Private sector units are not run efficiently. After running into losses, these units face closure. In the interest of the nation such units are, sometimes taken over by the government and run as state enterprises.

7. Helping in Social Change: - Public sector units can be used for furthering the welfare of people. This will help in bringing a new social order which is helpful for the progress of the country.

6.2.5 Disadvantages of Public Enterprises

1. Delay in Completion: - Public enterprises take long periods for completion. The delay may be due to non-release of funds in time, too much time taken in completing etc.

2. Faulty Evaluation: - Public enterprises are sometimes set up on political considerations. The projects are not properly evaluated on sound industrial principles. Faculty valuation of projects results in their failure and wastage of national resources.

3. Heavy Overhead Costs: - Public enterprises spend heavy amounts on unproductive expenses. Large amounts are first spent on providing housing facilities and other amenities to employees even before the units starts production.

4. Inadequate Returns: - The past experience in India shows that Public enterprises have failed to earn a fair return on investments. Inspite of many privileges enjoyed by these units many of them are either running losses or are earning in adequate returns as compared to investments.

5. Inefficient Management: - The important posts in Public enterprises are occupied by those who have no business experience but have political support. Such leaders are not able to inspire and motivate employees in improving their performance.

6. Lack of Man Power Planning: - Public sector units employ persons disproportionate to their needs. The jobs are created to fulfil employment goals of the government and not as per the needs of the organisation.

7. More Labour Problems: - Public sector enterprises face more labour problems as compared to Private sector units. The employees expect frequent wage hikes and resort to strikes for achieving their goals. Their job safety in these units makes them militants in pursuing their aims.

6.2.6 Role of Public Sector in Indian Economy

1. Employment Generation: - Public sector has been generating employment both in the Public sector enterprises and in government administration, defence and other government services. Manufacturing units of Public sector alone created employment to the extent as 18.61 lakh persons.

2. Development of Infrastructure: - Public sector investment on infrastructure sector like power, transport, communication, irrigation, education, health care, technical training etc., has been substained.

3. Strong Industrial Body: - Public sector has successfully built the strong industrial base in

the country. The Public sector industries in the fields of iron and steel, coal, heavy engineering, fertilisers and chemicals, natural gas have created a sound industrial base in the country.

4. Balanced Regional Development: - A number of Public sector units were set up in Orissa, Chattisgarh, West Bengal instead of metropolitan cities like Bombay, Madras, Delhi etc. The purpose was to setup the units to remove disparities in development.

5. Export Promotion: - Public sector enterprises have contributed a lot for the promotion of India's exports. Some units such as HMT, Hindustan Steel Ltd., State Trading Corporation have played an important role in achieving import substitution. This is solving precious foreign exchange.

6. Contributing to Government Exchequer: - These enterprises are contributing a good amount of resources to the central exchequer in the form of dividend, excise duty, custom duty, corporate taxes etc.

7. Exercising Social Control: - The Government of India has been embarking on an important role for the Public sector because it wanted to have a social control over factors of production.

6.2.7 Forms of Public Enterprises

Since India has followed mixed Economy it has become imperative for the government to enter into the business sector. The Industrial Policy Resolutions 1948 and 1956 also welcomed the government's penetration into the industrial sector. Accordingly many industries are being established and managed in the government sector.

Public enterprises in the manufacturing field have been organised in three forms.

1. Departmental Management.
2. Public Corporations.
3. Government Company Organisations.

6.2.8 Departmental Management

Department form of organisation of managing state enterprises is the oldest form of organisation. In this form the enterprise works as a part of government department. The finances are provided by the government and management is in the hands of civil servants. In India railways, post and telegraph, radio and television are working as government departments. In the same way strategic industries like defence, atomic power are under government.

I Characteristics

1. The undertakings are wholly dependent on government for finances. State treasury provides finances and surplus money is deposited in the treasury.

2. The management is in the hands of the government. The enterprise is managed and controlled by the civil servants of the government.

3. The budget of the department is passed by the parliament or by the state legislature.

4. The accounting and audit control applicable to other government departments are applicable to state enterprises also.

5. The department enjoys legal immunity.

Advantages

1. Useful for Specific Industries: - Departmental form of organisation is necessary for public utility services. Strategic industries like defence and atomic power cannot be better managed than under government departments.

2. Help in Implementing Government Policies: - Government policies and programmes are better implemented by the enterprises under direct government control.

3. Complete Government Control: - Departmental undertakings are completely under government control. These undertakings are associated with one of the government departments.

4. Legislative Control: - These undertakings are under the control of legislatures. Government is answerable to the legislature for the working of departmental undertaking.

5. Sources of Income for Government: - These undertakings are run on commercial lines. They can earn profits like Private enterprises. They provide finances to the government for initiating other social and development activities.

6. Secrecy: - Departmental undertakings can maintain secrecy in their working. Secrecy is especially necessary for undertakings like defence.

Disadvantages

1. Excessive Government interference: - There is an excessive government interference in departmental organisation. The undertakings are not given freedom to decide their own policies.

2. Centralisation of Powers: - All policies are decided at the ministerial level. The powers are centralised at the higher level.

3. Red Tapism: - There is a delay in taking important decisions. Red tapism is prevalent as in other government departments, commercial organisations cannot afford delay in taking decisions.

4. Inefficiency: - Losses in departmental undertakings are not taken seriously. They are run as governmental departments and not as commercial undertakings.

5. Shortage of Competent Staff: - Departmental undertakings are like administrative departments. Civil servants are given control of these undertakings. There is a shortage of competent persons who have commercial experience.

6.2.9 Public Corporations

A Public corporation is a separate legal entity created for a specific purpose. In India, the Reserved Bank of India, Damodar Valley Corporation, State Trading Corporation, Industrial Development Bank of India, Industrial Finance Corporation are some of the corporations created by special acts of parliament.

I Characteristics

1. Separate Legal Entity: - A Public corporation is created by a separate legislative act. It is a separate legal entity.

2. Government Investments: - These corporations are financed by the government. In some private capital may also be associated, but at least 51% of the shares are held by the government.

3. Financial Autonomy: - Corporations are not department on the state exchequer for its day to day financial requirements. Legislatures do not pass their budgets.

4. Service Motive: - The motive of Public corporations is to provide service to the public at a reasonable price.

5. No Government Interference: - Public corporations are free from government interference. They execute their independent policies.

I Advantages

1. Internal Autonomy: - Public corporations have internal freedom. They can devise their own policies and programmes. They can set their own goals and can decide their own line of action.

2. Flexibility: - There is no rigidity in their working as in case of departmental undertakings. The flexibility is necessary for the success of a business concern.

3. Free from Government interference: - Public corporations are free from government interference. They are not dependent on government departments. Various policies are decided independently. Management is free to manage these undertakings.

4. Run on Business Lines: - These undertakings are run on commercial lines. They also earn profits like private concerns.

5. Services to Society: - Public corporations provide commodities and services to the people at reasonable prices. Though they also earn profits their primary aim is to help the society in getting various services.

6. Accountability: - These undertakings are accountable to the legislative for their performance. They try to increase their efficiency.

I Disadvantages

1. Limited Autonomy: - Though public corporation enjoys internal autonomy, still governments' interference is there. All important policies are decided with government approval. Management is also appointed by the government.

2. Misuse oF Financial Autonomy: - Financial autonomy of the corporation is, sometimes, misused by the management.

3. Difficulty in Making Changes: - Any change in the sphere of activities of the corporations involves change in the statute of the corporation. The statute can be amended only by a legislature. It is a difficult process and takes much more time.

4. Government Control: - Though these corporations are autonomous bodies, still there are many controls exercised by the government.

5. Lack of Personal touch: - Corporations are managed by the salaried employees. Top managerial personnel are also paid employees. There is a lack of personal touch. Everything is managed in a routine way.

6.2.10 Government Company

A company owned by central or state government is called a government company. Either whole of the capital or majority of the shares are owned by the government.

"Government company means 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 governemnts or partly by the central government and partly by one or more state governments and includes a company which is a subsidiary of a government company".

—— Indian Companies Act 1956.

Government has to take over sick units in private sector. Nationalised industries can also be run up by government companies. Some of the examples of government companies in India are Coal Mines Authority Ltd., Steel Authority of India Ltd.

I Advantages

1. Flexibility in Management: - There is a freedom and flexibility in the management of government companies. Companies can organise their working according to the necessity of the situation.

2. Run on Commercial Lines: - Government companies are run on sound business lines. They earn surpluses to finance their own expansion plans.

3. Healthy Competition: - Government companies provide healthy competition to the Private sector. Private business men will have to be careful in fixing their prices.

4. Financial Autonomy: - These companies are dependent on the government only for their initial investments. They can plan their own capital structure. The companies can profits and these profits can be used for further investments.

5. Producing Industrial Environment: - An industrial infrastructure is provided by the government companies. They help the growth of ancillary units.

I Disadvantages

1. Slackness in Management: - The management of government companies is slackened under the garb of public service. These companies are not generally as efficient as units in the Private sector.

2. Political Interference: - There is a lot of political interference in government companies. Every government tries to nominate directors for its own political considerations.

3. Red-Tapism: - These companies are dependent on the government for taking important policy decisions. Red-tapism in government departments affects the working of these companies.

4. Limited Autonomy: - These companies are free from government control but in really they are dependent on various government departments. They have to get permission from government departments regarding loans, capital and managerial appointments.

5. Official Domination: - Civil servants are appointed on important managerial posts of these companies. They are not capable of running those undertakings on sound business lines.

6.3 Private Sector

The ownership and management is in private hands and this initiative is under taken for private gain. The New Industrial Policy 1991 welcomed the enthusiasm of private sector. This policy restricted the role of Public sector and opened an era of liberalisation where Indian as well as foreign companies were allowed to enter any field of their choice except a few exceptions.

6.3.1 Role of Private Sector

The Private sector has been playing an important role in Indian industry.

1. Dominant Sector: - Government of India specified role of Public as well as Private sectors. Some sectors were demarcated to be developed by Public sector, some were left to the initiative of Private sector while some areas were for both the sectors.

2. Private Entrepreneurs: - The person who is behind the process of development is known as entrepreneur. He is responsible for the introduction of new commodities, new techniques of production, assembling of various industrial inputs, developing of new markets etc.

3. Potential of Cottage and Small Scale Sector: - The cottage and small scale sectors are playing an important role in the industrial development of the country. This sector requires

less capital and has large potential for employment. In India there are less capital resources but abundant labour supply. The cottage and small scale sector is in Private hands. The government is providing loans at concessional rates of interest and is also helping in marketing of products.

6.3.2 Problems of Private Sector

1. Limited role: - Basic industries need large investments, gestation period is long and returns are slow, the private sector avoided investing in this area even though it was necessary. It shows that Private sector played a limited role in developing a sound industrial structure.

2. Creating Trade Deficit: - Private sector is creating imbalance of trade. This imbalance in trade puts pressure on foreign exchange resources of a country. The increasing competition from multinational companies has forced the Private sector to improve their production technologies.

3. Industrial Sickness: - The Problem of industrial sickness is creating problems for financial institutions. A large number of units started by private entrepreneurs are closed. The failure of lakhs of units creates imbalances in the economy. The main cause of these failures seems to be bad planning and wrong assumptions of the entrepreneurs while setting up such units.

4. Problem of Finance and Credit: - The capital formation in India is low and industrial units are not getting adequate finances. The scams in capital market have discouraged a common investor from purchasing shares of companies. The low interest rates on savings have further discouraged people from making productive use of their resources. The impact of all these factors has credited difficulties in raising funds by industrial units.

5. Foreign Competition: - The liberalisation policy of the government has opened flood gates for foreign competitors. The multinational companies have flooded Indian markets with cheap and high quality products. This competition has created an unfavorable situation for Indian industry.

6.4 Joint Sector

The concept of Joint sector is not new to India. The drawbacks of both Public and Private sectors were responsible for trying this new sector. In Joint sector government investment will be limited to 26 percent of total investment and the rest will come from private entrepreneurs and investing public.

6.4.1 Factors Governing Joint Sector

The main reasons behind the growth of Joint sector include.

1. Integration of both Public and Private sector.
2. Providing a third avenue for balanced industrial development.
3. Extention of the idea of mixed economy.
4. For pooling of lost and required resources for the development of a new project.

6.4.2 Features of Joint Sector

1. The Joint sector is meant to make optimum use of government investments with the help of private managerial and organisational expertise.

2. There is a specified criterion for making investments in Joint sector.

3. Unless other wise relaxed by central government, no single investor can hold more than 25 percent of the shares.

6.4.3 Advantages of Joint Sector

1. Joint sector was used as a tool of social control of industries.

2. There is a lack of managerial skill and professional managers in government sector.

3. Government and Private sector can join hands for making investments in important units which are essential for the economic development of the country.

4. Joint sector can play a useful role by mobilising both financial and scare highly developed human resources urgently needed for industrial development.

5. The Joint sector will widen the scope of industrial growth.

6. The Joint sector undertakings will take steps to provide goods at fair prices and will produce good quality goods.

6.4.4 Limitations of Joint Sector

1. The concept of Joint sector is laudable it has not achieved the desired results.

2. The Government should only guide the activities of units and should ensure the achieving of national goals.

3. A clash of interests in the partners creates problems for the undertakings.

4. The sharing should not only at capital level but all spheres of activities of the business should be covered to ensure a smooth working.

6.5 Co-operative Sector

Co-operative sector is working through co-operative societies set up in different fields. The aim of Co-operative Societies Act was to build a democratic, economically viable and self-reliant co-operative organisation in the country. The co-operative societies were set up to provide financial help to poor rural people so that they are not exploited by money lenders.

6.5.1 Features

The Co-operatives have the following features:

1. Voluntary and open membership.
2. Democratic management by elected representatives of members.
3. Motto of 'Self Help'.
4. Concern for community development.
5. Political and religious neutrality.
6. Co-operative education and training.

6.5.2 Weakness of Co-operative Movement

1. The co-operative sector lacks spontaneous growth. People are not associating with co-operative organisations voluntarily.

2. There is a wide spread illiteracy in rural India. People don't understand the significance of this movement and are not able to associate with it.

3. Rural areas lack banking facilities and it has retarted the progress of rural movement in India.

4. Co-operative societies don not have sufficient financial resources to meet the needs of the members. So, they have to depend upon money lenders who charge huge interest rates on loans.

5. The officials of the government do not whole heartedly support this movement.

6. This movement failed to develop non-credit societies such as marketing societies, warehousing societies etc.

7. The inefficiency in management has adversely affected the growth of this movement.

6.6 Short Answer Type Questions: -

1. Name the constituents of industrial sector?
2. Explain the meaning of public sector?
3. Describe important problems faced by Private sector?
4. Describe the features of Joint sector?
5. Explain the philosophy of co-operative sector?

Essay Type Questions: -

1. Discuss the role of private sector in industrialising the country?
2. Describe the need for Public sector in Indian context?
3. What type of problems the Private sector is facing at present?

4. What is joint sector? What role does it play in industrialising the country?

5. What do you mean by co-operative sector? Is it necessary for economic development?

6.7 Recommanded Books:

1. Industrial Organisation & Management — Sharma & Gupta.

2. Business Organisation & Management — S.C.Chaterjee.

3. Business Organisation & Management — M.C.Sukla.

Dr.M.Vijaya Lakshmi.

LESSON - 7

SIZE OF INDUSTRIAL UNIT

7.0 Objectives:

1. Concepts - Plant, Firm, Industry.
2. Measuring the size of a unit.
3. Factors determining the size of a unit.
4. Characteristics of optimum firm.
5. Factors determining the optimum size.
6. Assumptions of optimum size.

Structure

7.1 Introduction:

Size of a Unit and Scale of Operations:

The size of a business unit refers to the scale of its operations. Whether the scale of production should be small, medium or large depends mostly upon the availability of finances, managerial ability, marketing possibilities and efficiency expectancy. The size of a firm is associated with economic efficiency. A particular size of a unit may be more efficient than other sizes. A decision about the size of a unit is never final. An entrepreneur has a careful consideration for all factors which affect his efficiency and profitability. The scale of production should be adjusted according to the changing business situations.

7.2 Concepts:

1. <u>PLANT</u>: - It means an establishment for the production of goods or provision of service. A plant may mean a factory, a mill, an establishment or a retail shop. This means a place where actual production is done or a service is provided. It includes machinery, equipment and workers employed there in.

2. <u>FIRM</u>: - A firm is essentially a unit of ownership, control and administration. A firm is a wider term as compared to a plant. It not only includes technical units i.e plant but also includes units of finances, marketing, management and enterprise. A firm may own one or more plants.

3. <u>INDUSTRY</u>: - The term industry refers to the aggregation of firms in the same line of production. The firm may use the same new material or may produce the same products, even if the raw materials used are different e.g textile industry. All the firms engaged in the production of sugar will comprise sugar industry. So, the word industry includes all the firms engaged in the production of similar products.

7.3 Measuring the Size of a Unit:

The business units are different sizes. The size of units depends upon the nature of products and methods and equipments used for production. Different industries may have different sizes. The iron and steel industry and cement industry, due to their nature, tend to have large size units. In the same way, public utility services like electricity, railways etc., have large units because of their nature. On the other hand, an entreprise dealing in artistic goods may tend to be small size. The industries engaged in dairy products, shoe-making and bread making may require medium size of their units.

It is very difficult to measure an exact size of a unit because of lack of standard measures. Standards may differ from industry to industry. The following measures are commonly used

1. <u>Amount of Capital Investment</u>: - The amount of capital invested is used as a measure for the size of a firm. The larger the investment the larger will normally be the size of the unit. If investment is less, then the size of that unit will also be small. The amount of capital can also be used to compare the size of two or more units. The difficulty arises in calculating the amount of capital invested.

2. <u>Volume of Output</u>: - The number of goods produced by a unit may also be used as a measure for the size. This is possible only if firms are engaged in producing similar or homogeneous products. This method may not be suitable for textile industry where a large variety of products are produced. This method may suit sugar and cement industries because of homogeneity of products.

3. <u>Value of Output</u>: - In industries where quantity of output is not comparable because of variety of goods, the value of products can be suitably used. This method for measuring the size is reliable as compared to many other methods. But a problem may arise when price fluctuations are frequent.

4. <u>Size of the Assets</u>: - Under this method, the total investments are represented by the assets of the unit are considered. It gives a clear picture of the total investments in the unit. The Times of India, a daily news paper, uses this method for its study of 'Corporate Gaints' in India. It reflects the relative rank of different industrial magnets like, Ambanis, Tata, Birla etc.

5. <u>Employment</u>: - The total number of workers employed in a firm is considered under this criterion. Generally, the bigger firms employ more employees as compared to smaller ones. This criterion suffers from the following limitations.

a) Capital intensive units may employ lesser number of workers as compared to labour intensive units.

b) The growth in investments and the number of employees may not be proportionately related.

c) The seasonal employment may also vitiate the analysis.

6. <u>Amount of Raw Material Consumed</u>: - The annual consumption of raw materials by a firm can also be used as a standard for measuring its size. The method can be used where same type of raw materials are used by different firms and the products to be produced are also similar.

7. <u>Amount of Power Used</u>: - Total power consumed may also be used for measuring the size. This method is used on the presumption that more the consumption of power, the more the output of goods.

8. <u>Complexity of Management</u>: - Peter F.Drucker uses complexity of top management as a measuring rod for the size. According to him, the more the complexity in top management, the larger the scale of operations and the lesser the complexity, the smaller will be the scale of operations. It is very difficult to measure the complexity of top management. This method is used on qualitative judge ment and not quantitive comparision.

7.4 Factors Determining the Size of a Unit:

The following factors affect the size of a unit.

1. <u>Nature and Demand for the Product</u>: - If the product is durable in nature and can be transported to distant places easily, the production will be possible on large scale. If the product is of perishable nature and cannot be stored for a longer period, then small scale production will be possible than large scale. If the demand is large, then the scale of operations may also be large, if demand is only I local, then production will also be small.

2. <u>Financial Requirements</u>: - The nature of an industry may be such that large sums of money are required. In case of iron and steel, cement and ship-building industries, large investments are neces - sary. The scale of operations will naturally be large in these industries.

3. <u>Cost of Transport</u>: - When raw materials are brought from a far off place and finished products are also to be carried to distant places, the cost of transport will be heavy. It will increase the cost of production. The firm will not be able to compete in the market. The raw materials should be produced locally and production should also be for local markets.

4. **Market: -** If market of a firm is limited, the production should be on a small scale. When the market for the products is national or international production should be on a large scale basis. So market also affects the size of a unit.

5. **Entrepreneurial Ability: -** Entrepreneural capabilities also determine to a large extent the size of a unit. With the expansion of a unit, the tasks of organisation and co-ordination become difficult and complicated. The sizeof a unit is determined by the organising ability of the entrepreneur.

6. **Government Regulations: -** The rules and regulations of the government also influence the decision about size. If the investments are to go beyond a certain limit then permission of the government is necessary. Large scale units attract more tax burdens. Small scale units are generally free from gvernment regulations.

7.5 Optimum Firm:

The main aim of every enterprise is to earn more and more profits. To achieve the objective, the entrepreneur tries to use all productive resources economically. The idea is to reduce cost of production. The firm is expanded to such an extent where output is maximum and cost of production is minumum. The point at which average cost is minimum is called optimum point. If production is increased beyond this point, then average cost will go up. If production is less than this point then there will still be a possibility of reducing cost. It is a point which every firm tries to achieve.

The optimum point is an ideal size of a unit. Every entrepreneur tries to reach this point. Once a unit reaches the optimum point, it will try to stick at that point. The optimum point is different for different industries. It largely depends upon the nature of industry. In case of iron and steel, cement, automobiles and oil refining industries the units are of a gaint size but in industries like agricultural implements, dairy farming, the size of the units will be small. Moreover the optimum size goes on changing with the change in technology and managerial methods.

“By the optimum size we must mean that firm which, in existing conditions of technique and organising ability, has the lowest average cost of production per unit, when all those costs which must be covered in the long run are included”.

----- Prof. E.A.G.. Robinson.

“In an ideal word, all firms should expand untill they are producing these outputs which they produce at a lower average cost than any other output”.

----- A.Beacem.

“That organisation of business enterprise which in given circumstances of technology and the market for its product can produce its goods at the lowest average unit costs in the long run”.

-----R.T.Bye.

7.6 Characteristics of Optimum Firm:

1. Minimum Average Cost: - The average cost per unit should be minimum. The average cost can be calculated by dividing the aggregate cost by total output in units. Some times the firm may earn huge profits but it may not achieve optimum size. The profitability is affected by many factors like selling price, nature of demand and market situations etc.

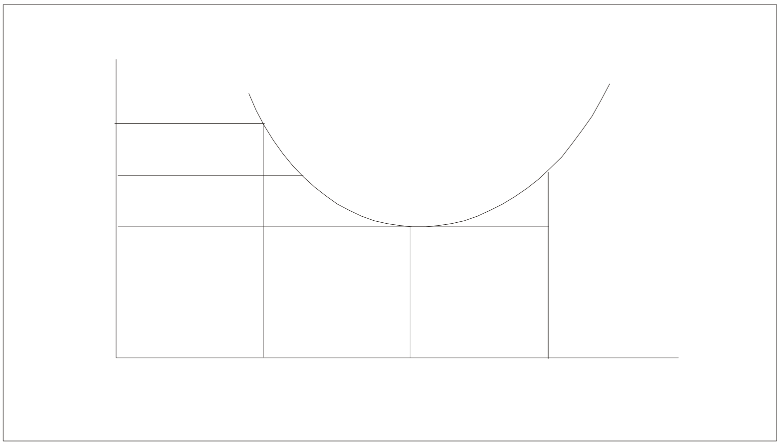
2. Short Term and Long Term Costs included: - While calculating average cost per unit, all costs whether short-term or long-term should be included. It means that fixed expenses of a firm including depreciation, interests etc., should also be included.

3. Technical and Managerial Factors: - The optimum size is considered at the existing managerial and technical factors. If there is an improvement in technology or in managerial methods, the optimum size may also go up. The optimum size of different industries will be dependent upon marketing and technical and financial conditions.

4. Efficient Use of Various Factors: - The minimum cost can be attained only when all types of wastages are eliminated. All factors of production are used to their maximum possible extent and there is no other way to use them more economically and more effeciently.

■ **Diagrammatical Presentation:**

The optimum size is shown in the diagram as under



In the diagram axis OX measures the size of units and axis OY measures the average cost per unit. At point A, average cost per unit is minimum and this is the optimum size. If the output is less i.e. OS , there is a possibility of decreasing the cost by expanding the operations of the units. When the production in increasing beyond optimum point i.e. S , then the average cost starts increasing. So, at point, A(i.e. size S) the average cost is minimum and this is the optimum size of the unit.

7.7 Assumptions of Optimum Size:

There are two important assumptions in discussing the optimum size of a unit.

1. There should be perfect competition in the market. The prices are determined by the forces of de- mand and supply.

2. It is presumed that a sufficient market exists which will absorb the whole production of the optimum firm. It implies that the firm will not be lowering its prices to sell its products in the market. So, whatever is produced will be absorbed by the existing market.

n **Criticism of Optimum Size:**

1. The conditions of perfect competition hardly exist. It is also not possible to measure the degree of competition at a given time.

2. The optimum size of a firm is unrelated to perfect competition in the market. Optimum size is related to efficient use of factors of production.

3. It is difficult to describe optimum size in different industries. The optimum size is dependent upon different factors in different industries.

7.8 Factors Determining the Optimum Size:

The factors which determine the size of a unit may be divided into five categories.
1. Technical Factors.
2. Managerial Factors.
3. Financial Factors.
4. Marketing Factors.
5. Factors of Risk and Fluctuations.

1. Technical Factors: - The technique of production largely affects the size of a unit. Technical factors operate in favour of an increasing size. The optimum use of technical factors can be achieved through two processes

a) Division of Work.
b) Integration of Processes.

The optimum use of technical factors can be achieved through
1. Use of machines in place of labour.
2. Introduction of division of labour.
3. Fuller utilisation of capacity.
4. Standardisation of products.
5. Integration of production processes.

2. Managerial Factors: - Managerial economies are possible in case of a large firm. The

success of a firm depends upon the organising capability of the top management. The expansion of production is necessary to distribute the managerial cost among large units. Managerial economies can be achieved through two processes.

a) Division of Labour: - As in case of technical forces, division of labour is done for managerial jobs too. Business activities are divided into different functions such as production, finance, marketing, accounting, record keeping, personnel etc. The division of mangereial work will bring in more efficiency.

b) Process of Integration: - The managerial economy can be achieved through the process of integration. small managerial functions can be integrated and performed by fewer persons. The use of type writers, calculators, dictating machines, accounting machines etc. have reduced the managerial costs. The purchase of these appliances is a costly affair. The managerial factors also encourage large scale production. The increase in production will bring down managerial costs per unit.

3. Financial Factors: - The size of business unit is directly influenced by the availability of finances. The finances are required firstly for establishing a unit and then for expanding. If the financial needs will be in the form of fixed and working capital. The availability of funds directly and indirectly influences the size of a unit. Then finances should be raised according to the needs of different periods. The funds should be put to a maximum use. When the funds are used judiciously, then the optimum use of financial factors will be achieved.

4. Marketing Factors: - The extent of market influences the scale of production and also raise certain marketing problems. Certain marketing economies are available if the scale of purchase and sale is higher.

When buying is done on a large scale, it brings in a number of economies, saving in freight etc. The purchase of large quantities will enjoy favourable terms and conditions. A large firm can afford to use the services of marketing experts. The marketing specialists will be able to select proper products and will be in the know of right time and place for purchases. All these economies are possible in bigger concerns only. The large the size of the unit, the more will be the economies in marketing costs. Small scale concerns will not be able to achieve marketing economies to a large extent.

5. Factors of Risks and Fluctuations: - The frequent changes in demand should be considered while planning the size of a firm. There are always fluctuations in demand. The demand for goods may be influenced by a number of factors. The changes in demand may be of four types. These are

a) Permanent Changes: - The demand for a product may undergo a permanent change. This may happen due to change in fashion, tastes, technology of methods of production.

b) Cyclical Changes: - These changes occur due to depression or boom. During depression production is more than demand. Big concerns will be able to withstand this situation and will survive during depression. Small units can exist only through amalgamation of units.

c) Seasonal Changes: - Some commodities may be in more demand during a particular season and their demand will decline when the season is over. The unit should take up the production of a number of goods required during different seasons so that production may be subjected according to the demand.

d) Erratic Changes: - Sometimes, the change in demand is not caused by a specific reason it may be caused by different factors at different times.

The factors of risks and fluctuations favour a small size because the adjustments can be easily made and re-organisation will be less costly.

7.9 Some Other Concepts:

7.9.1 Representative Firm:

1. REPRESENTATIVE FIRM: - Alfred marshall used the term "Representative Firm, in his 'Principles of Economics'. By a representative firm, he means a firm which is running effeciently for fairly a longt ime.

"A firm which has had a fairly long life and fair success, which is managed with normal ability and which has normal access to the economics, external and internal, which belong to the aggregate volume of production, account being taken of the class of goods produced, the conditions of marketing them and the economic environment generally.

----- Alfred Marshall.

7.9.2 Equilibrium Firm:

2. EQUILIBRIUM FIRM: - This is the state of a firm from which the entrepreneur does not want a change. This is the position where entrepreneur feels satisfied. He earns more profits at this level of operations.

"A firm will be in equilibrium when the industry as a whole will be in equilibrium. The entrepreneur will neither like to increase nor like to decrease his production from the equilibrium point".

----- Pigou.

The concept is far from reality. No business man will like to determine the equilibrium size of the firm.

7.9.3 Passimum Firm:

3. PASSIMUM FIRM: - The firm is not able to achieve the economies of large scale. The transitional period in the life of an expanding firm is called "Passimum Firm".

"It is the size of a firm which combines the technical disadvantages of smallness with the managerial disadvantages of being too large for individual control".

----- Robinson.

7.10 Self Assessment Questions:

1. How can the size of a unit be measured?
2. Give time factors for a determining the size.
3. Distinguish between a plant and a firm.
4. Explain the assumptions of optimum size.
5. Discuss managerial factors influencing the size of a firm.

■ **Essay Type Questions:**

1. What do you understand by the term “Size of a business unit”? How can the size be measured?
2. Explain the various economies enjoyed by large-scale units.
3. What is meant by optimum firm? Give the factors which determine the optimum size of a firm.
4. “The final size of the business unit as a whole depends upon the reconciliation of different optima” Explain this statement.
5. “This concept of optimum firm is not a stagnant one” Explain this statement.

7.11 Reference Books:

1. Industrial Organisation & Management --- Sharma & Gupta.

2. Business Organisation & Management --- S.C.Chaterjee.

3. Business Organisation & Management --- M.C.Sukla.

Dr.M.Vijaya Lakshmi.

LESSON - 8

STATE AND INDUSTRY

8.0 Objectives:

A careful study of this chapter will enable you to understand the

-Factors affecting industrialisation
-Industrial policy resolutions 1948, 1956, 1980, 1991.

Structure

8.1 Introduction:

Industrialisation of a country is essential for accelerating the process of development. Every government tries to encourage the growth of industrial sector. The concept of industrialisation refers to the development of industries in every part of the economy by exploiting the available resources. The use of latest technology, better methods of production, innovative marketing and better managerial techniques are encouraged for achieving overall economic development. Undeveloped countries have various industrial inputs but not the persons to make use of them. The role of an entrepreneur all the more becomes important. Industrialisation can better be achieved if all factors of production are judiciously and economically put to use and a co-ordinated effort is made for all round development.

8.2 Factors Affecting Industrialisation:

1. Economic and Infrastructural Factors: - Industrialisation is possible only when adequate infrastructural facilities are available and sufficient economic resources are there. The infrastructure factors include rail, roads, ports' power, tele communication etc. while economic factors include the availability of capital (both domestic and foreign) developed capital and money markets, lending agencies such as banks and financial institutions etc. The availability of all these factors is essential for industrial development.

2. Socio-Cultural Factors: - The social and cultural factors have an important bearing on the industrialisation of a country. The factors like literacy rate, technical education, work culture, saving and spending habits, social harmony play an important role in the development of a country. The literacy of the population is a must in creating healthy atmosphere in the country. Industrial development will require the services of skilled workers. Technical education should be encouraged to supply trained work force. When people are in the habit of saving, they will be providing funds for existing and new industrial units. The savings can be chanelised through banks, mutual funds and such other agencies. The main problem in india is the absence of work culture. The trade unions have always created problems whenever some management tried to force work culture. Govt. offices remain closed for one-third days of the year due to one holiday or the other.

3. Appropriate Technology and Managerial Techniques: - Industrialisation will be possible only when technology suitable to the country is employed. Everyday there are technological innovations. Every type of technology will not be suitable everywhere. The environment prevailing in a country will help in deciding the mode of technology to be employed. In a country like India where abundant cheap labour force is available, such technological methods should be used which can make use of labour. The use of more labour can reduce cost of production also. In a developed country where labour force is very costly, more automation may be the best answer. The selection of appropriate technology will help in increasing the pace of industrialisation. The managerial techniques will also help the industrialisation process. Those techniques should be employed which can help in enhancement of productivity.

4. Government Policies: - Various policies framed by the government have direct bearing on industrialisation in the country. The policies like investment policy, monetary policy, fiscal policy, Exim policy, foreign exchange policy, public sector investment policy have direct effect on the industrial atmosphere in the country. Every government decides on the priority areas where investments are encouraged. The policy measures undertaken by the government can help in enhancing the pace of industrialisation. The free flow of direct foreign investment in the economy has further increased the pace of industrialisation.

8.3 Industrial Policy in India

8.3.1 Meaning and Importance of Industrial Policy

Industrial policy refers to those actions of the State which influence growth of the industrial economy of a country. The term Industrial Policy is made up of two components. One is the philosophy to determine the shape of the industrial growth. Second component consists of rules and regulations designed to implement the policy so as to achieve its objectives.

A well designed industrial policy is of vital importance as the pace and pattern of industrialisation greatly depand upon the type of industrial policy formulated. In developing countries, like India, which are using planning as an instrument of development, industrial policy is of great importance due to the following reasons:

1. The Government has to earmark certain areas of economic activity for itself (public sector) and leave other areas for private sector so as to make the optimal use of limited resources.

2. The second reason is the need for proper regulation of the private sector so as to make it fall in the plan framework.

3. Thirdly, it is also essential to regulate and co-ordinate the activities of the domestic and foreign sector so as to fit in the planned programme of development.

8.3.2 Pre-independence Policy

The British Government in India took no steps to put India on the path of industrial development. It was keen on making India purely an agricultural colony and an economic sattelite of the British Empire. It was in the interest of the British Government to keep our country as a source of food and raw materials and a market for the British industrial products. Thus, the Government followed the policy of laissez-faire in respect of industrial development which ‘could not possibly promote and protect, assist and encourage Indian-industries.

8.3.3 Post-independence Policy

Immediately after the country became independent, the national Government felt the need for developing industries in a planned manner in the national interest. The Government convened the Industries Confrence in 1947 which emphasised the need for a clear cut demarcation of the role of private and public sectors. To implement the recommendations of the Industries Conference, the Government declared its first Industrial Policy in 1948.

8.4 Industrial Policy Resolution, 1948

The Government of India announced a comprehensive Industrial Policy on April 6, 1948 with the following general objectives:

1. Establishment of a social order where justice and equality could be secured for all.

2. Rapid rise in the standard of living of the people.

3. Increasing production.

4. Acceleration of industrialisation.

5. Providing employment opportunities to all.

Features of 1948 Policy

The state accepted the responsibility to actively participate in the development of industries. The industries were divided into four categories:

(a) Industries like arms and ammunition, atomic energy etc. to be the exclusive monopoly of the state.

(b) Industries like coal, iron and steel, air-craft, ship building etc. where existing units allowed to exist but new units to be set up in public sector.

(c) Industries like automobiles, tractors, fertilizers etc. to be regulated by central government in consultation with concerned state.

(d) Rest of the industrial field left to private sector.

1. Mixed economy pattern was adopted.
2. The importance of small scale and cottage industries was recognised.
3. Unfair foreign competition will be avoided through tariff measures.
4. Coordial relations between management and labour were recognised.
5. Foreign capital investment was encouraged only under Indian control.
6. Taxation policy to discourage concentration of wealth.

8.5 Industrial Policy Resolution, 1956:

On April 20, 1956 the Government of India adopted another Industrial Policy Resolution which replaced the 1948 resolution. The new resolution has become necessary due to the changes and developments that had taken place during the eight years. The Constitution of India was enacted, guaranteeing certain Fundamental Rights and enunciating Directive Principles of State Policy. Planning had proceeded on an organised basis and the First Five-Year Plan had been completed. The Parliament had accepted socialistic society as the objective of social and economic policy. Above all, the target of investment in heavy industries and mining fixed at Rs. 890 crore in the Second Five-Year Plan could be achieved only through a complete reorientation of industrial policy.

Objectives of The Policy

The Resolution laid down the following objectives to be achieved under the Industrial Policy:

1. to accelarate the rate of economic growth and to speed up industrialisation;
2. to develop heavy industries and machine making industries;

3. to expand the public sector;

4. to build up a large and growing co-operative sector;

5. to reduce disparities in income and wealth; and

6. to prevent private monopolies and the concentration of economic power in different fields in the hands of small number of individuals.

Main Features of 1956 Policy

1. Industries were classified into three categories:

(a) Seventeen industries in strategic sectors to be sole responsibility of the state

(b) Twelve industries such as aluminium, machine tools, anti-biotics, fertilizers, rubber, synthetic etc. will be progressively state owned and state to take initiative for setting up new units.

(c) Remaining industries left for private sector but still has the option of entering any industry in this category also.

2. Small scale and cottage industries to be helped through taxation measures and state subsidies. Industrial co-operatives to be encouraged.

3. Reduction in regional disparities by extending infrastructural facilities.

4. The need for technical and managerial personnel was recognised and efforts to be made for creating training facilities.

5. Need was felt for sound industrial relations and incentives for labour. Improvement in working and living conditions of workers was felt.

6. The public sector units to be managed on sound business lines. This sector was expected to generate revenue for further developmental purposes.

Critical Appraisal Of 1956 Policy

Merits: - TheIndustrial Policy of 1956 offered the following merits:

1. It was a determined effort on the part of the Government to accelerate the rate of economic and industrial growth.

2. It ushered a new era of active participation of the Government in industrial development of the country.

3. It was a comprehensive policy as it covered the entire industrial field, e.g., basic and heavy industries, large industries and cottage and small scale industries.

4. It provide a concrete framework for the implementation of plan objectives.

5. It assigned an important role to the public sector in the industrial field.

6. It recognised the need for sound industrial relations and labour welfare.

7. The achievements of this policy include establishment of a large number of new industries and accelerating the pace of industrialisation in the country.

Criticism:

The criticism levelled against the Resolution is as follows:

1. The Resolution greatly reduced the space for private enterprises. Some people saw in it the beginning of State capitalism.

2. Many industrialists and thinkers have criticised the policy on the ground that it is influenced more by the ideological consideration than by the actual needs of the country.

3. The Resolution envisaged flexibility but it was intended primarily to operate in favour of the public sector because the State could enter into any industry or trade. The sword of State intervention and nationalisation hanging over the private enterprises would discourage investment in the private sector.

4. It placed greater emphasis on the public sector. Many thinkers pleaded that free enterprise be made the normal practice and State enterprise being confined to cases where there was proved necessity for it.

5. The policy was also criticised on the ground that if rigidly applied, it could result in imposing heavy additional burden on the already overstrained financial and managerial resources of the public sector restricting the rate of development in the important industrial fields.

6. Doubts have also been expressed about the competence of the Government to establish and run industries efficiently by the advocates of private sector.

7. The Public Resolution enlarged the powers and role of Government in the industrial field. Some see in it the beginning of State capitalism and the ultimate extinction of entrepreneurial activities in the country.

8.6 Industrial Policy Statement, 1973

The question of amending the Industrial Policy Resolution of 1956 has been coming up for consideration at various levels from time to time. The Government of India adopted a new Industrial Policy Statement on February 2, 1973. The new Policy Statement of 1973 again made it clear that the Industrial Policy Resolution would continue to govern the industries for achieving the objectives of growth, social justice and self-reliance in the industrial sphere. Though the basic structure of 1956 Resolution was kept intact, yet certain important amendments were introduced. The Government accepted the proposal of the Dutt Committee (also know as the Industrial Licensing Policy Enquiry Committee) for setting up the 'Joint Sector'. The joint sector was concieved as a sector in which both the public sector and private sector jointly organise a production activity.

8.7 Janata Party Governments' New Industrial Policy, December, 1977

Mr.G.Fernandes, the then Union Minister for Industries placed before the Parliament the New Industrial Policy Statement on December 23, 1977. The chief objectives of the statement are:

1. Maximum output of consumer goods.
2. Maximum utilisation of human and natural resources.
3. Prevention of monopoly and cencentration of economic power in few hands.
4. Promotion and nurturing of village and small industries widely dispersed in rural and semi-rural areas.
5. Creation of a tiny sector which will develop labour-intensive industries and offer self-employment opportunities.
6. Inducing the industry to become more and more responsive to, social needs and apirations so that the benefits to industrial growth will be shared equitably by all the people.

8.8 New Industrial Policy Statement, July, 1980

The Indira Gandhi Government announced its new industrial policy in July, 1980. Broadly speaking, the new policy seeks to promote the concept of economic federalism, offers a new deal to the private sector, promises to improve the efficiency of the public sector and seeks to reverse the trend of the past three years (or Janata Govt.) towards creating artificial divisions between small-scale and large scale industries.

- **Features of Industrial Policy 1980**

1. Role of Public Sector: - The policy statement accepted that there has been an erosion of faith in public sector in recent past. A drive is to be launched for reviving the effeciency of public sector undertakings.
2. Economic Federalism: - The artificial division between small scale sector and large scale sector will be eliminated. The policy proposes to promote the concept of economic federalism with the setting up of few nucleus plants in each district identified as industrially backward to generate as many ancillaries and small and cottage units as possible.

3. Redefining of Small Scale Units: - In view of the marked rise in prices and to boost the development of small scale industries, the criteria for small scale sector as revised as follows: -

(a) The investment limit in case of tiny units has been increased from Rs. 1 lakh to Rs. 2 lakh.

(b) The limit of investment in plant and machinery in the case of small scale units has been increased from Rs. 10 lakhs to Rs. 20 lakhs.

(c) The limit of investment in ancillary limits has been increased from Rs. 15 lakhs to Rs. 25 lakhs.

4. Rural Area Industry: - In order to generate employment opportunities and higher per capita income in rural areas, suitable industries are to be encouraged. Handlooms, handicrafts and Khadi and other village industries would be given greater attention to achieve faster rate of growth in the villages.

5. Regularisation of Excess Capacity: - This policy resolution further simplified the procedure for regularisation of unauthorised excess capacity. The FERA and MRTP were also to be considered for this regularisation.

6. Automatic Expansion: - The large scale sector was allowed automatic extension to all industries specified in the First Schedule of the 1951 Industrial Development and Regulation Act.

7. Removal of Regional Imbalances: - In order to correct regional imbalances, government would encourage dispersal of industry and setting up of units in industrially backward areas.

8. Industrial Sickness: - In order to overcome the problem of sickness, the government would encourage to merger sick units with healthy units, government will allow tax concessions for this purpose. Government also proposed to deal with industrial sickness due to mismanagement and financial improprieties.

8.9 New Industrial Policy, 1991

The Government of India announced a New Industrial Policy on July 24, 1991. It was a bold step in the direction of streamlining the setting up of new units and simplifying procedures for expansion of existing enterprises. This policy aimed at the following objectives: -

1. Unshackle the India Industrial economy from unnecessary bureaucratic controls.

2. To correct the distortions or weaknesses involved in the policy.

3. To abolish restrictions on direct foreign investment.

4. To liberalise home industry from restrictions of M.R.T.P. Act.

5. To maintain a sustained growth in productivity.

6. To reduce the load of public sector enterprises.

8.9.1 Features of New Policy

The main features of the New Industrial Policy are discussed as follows:

1. Abolition of Industrial Licensing: - In order to liberalise the economy and to bring transparency in the policy, the new policy has abolished the system of industrial licensing except for 18 industries. The industries under licensing will be only due to reasons of security and strategic concerns, social reasons, hazardous chemicals and overriding environmental concerns and items of elitst consumption. The industries under licensing are Coal and liquite, petroleum and its distillation products, distillation and brewing of alchoholic drinks, sugar, animal fat and oils, cigars and cigarattes of tabacco and manufactured tabacco substitutes, asbestos and asbestos based products, plywood and decorative veneers and other wood based products, raw hides and skins, leather, charmois leather and patent leather, tanned and dressed skins, motor car, paper and newspring electronic aerospace and defence equipment, industrial exlosives, hazardous chemicals, drugs and pharmaceuticals, entertainment electronics, white goods such as domestic refrigerator, washing machines, microwave ovens and air conditioners.

   The compulsory licensing provision would not apply in respect of the small scale units taking up the manufacture of any of the above items reserved for exclusive manufacture in the small-scale sector.

2. Role of Public Sector: - The public sector enterprises were not showing good results inspite of huge investments. The new policy reduced the list of industries. from 18 to 8 reserved for public sector. The industries reserved are:

   (a) arms and ammunition
   (b) atomic energy
   (c) coal and lignite
   (d) mineral oils
   (e) mining of iron ore, managanese ore etc.
   (f) mixing of copper, lead, zinc, tin etc.
   (g) minerals specified in the schedule to the atomic energy
   (h) rail transport.

3. Concessions from Monopolies Act: - The new policy states that the pre-entry scrutiny of investment decisions by so called MRTP companies will no longer be required. It was not necessary to obtain approval of the centre for expansion, establishment of new undertakings, merger, amalgamation and take over and appointment of directors under certain circumstances.

4. Foreign Investment and Technology: - The new policy prepared a list of 34 industries where automatic permission will be available for direct investment upto 51 per cent

foreign equity. The industries included in this list were metallurgy, boiler and steam generating plants, electrical equipment, telecommunication equipments, transportation, industrial and agricultural machinery, chemicals, food processing, hotel, tourism industry.

From the years 1997-98 onwards, foreign direct investments were further liberalised. In some sectors FDI's could go upto 100 per cent. In 2000-01, 100 per cent foreign direct investment permitted for business to business, e-commerce, oil refining, in Special Economy Zones for all manufacturing activities, telecom sector etc. In the year 2001-02 more concessions were allowed:

(a) 100 per cent FDI allowed through automatic route in pharma sector
(b) 100 per cent in airports
(c) 100 per cent in hotel and tourism industry
(d) 100 per cent in courier services and Mass Rapid Transport System
(e) 100 per cent FDI in Internet Services Providers etc.

5. Location Policy Liberalised: - The new policy mentioned that in location other than cities of more than 10 lakh population no industrial approvals from the centre will be required except for industries subject to compulsory licensing. In cities with more than 10 lakh population, industries other than those of non-polluting in nature will be located outside 25 kms of its periphery. However electronics, computer software and printing industry may be located within 25KM on periphery. Amandment in location policy was made during 1997-98.

6. Abolition of phased manufacturing programmes: - In order to increase indianisation, a phased manufacturing programme was enforced earlier. The new policy has totally abolished such programmes as the government feels due to substantial reforms of trade option policy and devaluation of rupee there is no need to reforce such programmes.

7. Convertibility Clause Removed: - Financial institutions had the option of converting their loans into equity shares. This option is resented by the industry. The new policy abolished this clause.

8.9.2 Merits of New Industrial Policy

Following are the main merits of new industrial policy:

1. Increase in Efficiency: - The changes in industrial licensing policy, foreign technology agreements, foreign investments have simplified the procedures and encouraged more investments. The time taken for various clearances have been done away with. All this will bring efficiency in the system.

2. Liberalisation: - The new industrial policy has liberalised the economy by removing bureau-cratic hurdles in the way of industrial development. The role of private sector has been increasing by reducing the list of industries reserved for public sector. The policy has also removed the limit of assets fixed for MRTP companies and dominant undertakings.

3. Increase in Competition: - This policy has laid emphasis on controlling and regulating monopolistic, restricting and unfair trade practices. All these measures will result in healthy competition among various industrial units.

4. Higher Production: - The policy has encouraged the import of latest technology, foreign investments and managerial expertise. All these measures will lead to better and higher production. The addition of more resources in the economy will increase production capacity of the industrial sector.

5. New Role of Public Sector: - The public sector has been assigned a new role in the new policy. The list of reserve industries for this sector has been reduced from 17 to 4. The private sector can enter into even strategic industries.

6. Encouragement to Small Scale Sector: - The growth of small and tiny sector was emphasised by giving a separate statement for their development. The government will provide enhanced support to the small scale sector so that it flourishes in an environment of economic efficiency and technology upgradation.

7. Protecting Interests of Employees: - Since disinvestment in PSU could lead to lay-offs and retrenchments, the government proposed to set up National Renewal Fund for the settlement and betterment of workers. The policy made efforts to protect the interests of workers by setting aside funds for their welfare.

8.9.3 Demerits or Shortcomings of the Policy

1. Reducing the Role of Public Sector: - The role of public sector has greatly been reduced by the new industrial policy. The list of reserved industries for public sector was first reduced from 17 to 8 and then to 3. This means that public sector will not have a monopoly in running a large number of industries. Secondly, the sick and loss making units may either be restructured or sold in the market. So this policy has restricted public sector to only some strategic industries.

2. Concentration of Economic Power: - It is feared that new industrial policy may lead to more concentration of economic power. The industrial sector in India is mainly in the hands of some industrial houses, the entry of private sector in more areas may lead to more concentration of economic power in few hands.

3. Ignoring Social objects: - The Five year plans and earlier industrial policies emphasised social objectives as the main aim of these measures. New industrial policy has reduced the role of public sector and the objective of socialistic pattern of society has not been kept in mind. The new policy may lead to more concentration of economic power in private hands .

4. Fear of Regional Imbalances: - The liberalisation of industrial licensing and lessening of controls will give freedom to provide enterprises to select the locations for new enterprises. Generally, the developed areas and regions will be preferred for new develop-

ment since various facilities will be available at those places. There is a fear of regional imbalances in future development.

5. Privatisation may not lead to Efficiency: - This policy assumes that more entry of private sector into restricted industries will bring more efficiency into the system. In fact privatisation without competition will result in inefficient private sector monopoly. It has greatly been observed that private sector is not a cure for industrial inefficeincies.

8.9.4 Criticism of 1991 Policy

New Industrial Policy 1991 created all round hopes for accelerating economic growth in the country, but in reality it has not happened. This policy is criticised on the following grounds:

1. No Impact on Industrial Growth: - This policy statement removed many barries for investments in different sectors. Foreign capital was freely allowed, licensing system was dispensed with. Inspite of all such positive steps there is no positive impact on industrial growth.

2. Threat of Foreign Competition: - Indian industry welcomed the new policy. They realised later on that liberalised system has allowed many MNC's to come to India.

3. Imbalance in Production Structure: - The capital goods industries are essential for laying a sound foundation for industrial growth. In the last decade the average growth rate in this sector has gone down from 9.4 per cent per annum to 5.4 per cent per annum. On the other side the average growth rate of consumer durable goods sector was high as 11.6 per cent per annum.

4. Misplaced Faith in Foreign Instvestments: - Government has been encouraging foreign direct investment in various fields since new industrial policy. A feeling was that it will supplement domestic investments, help in technology upgradation, increase export potential. These hopes have not be fulfilled by foreign investors. Multinational companies have taken over many products with popular brand names and have replaced them with their own products.

Dr.M.Vijaya Lakshmi.

LESSON - 9

GLOBALISATION

GLOBALISATION OF BUSINESS

9.0 Objectives:

A careful study of this chapter will enable you to understand the:

1. Essential conditions for Globalisation.
2. Impact of LPG Policies on Indian Economy.
3. Multinational corporations.
4. Methods, benefits, disadvantages of MNC.

Structure

9.1 Introduction:

Globalisation means integrating the economy of a country with the world economy. Globalisation is an attitude of mind, it is a mind-set which view the entire world as a single market so that the corporate strategy is based on the dynamics of the global business environment. Globalisation does not come merely by making investments in other countries of marketing at international level.

Globalisation involves the following:

1. Doing or planning to expand business globally.
2. Developing the global outlook of the business by giving up the distinction between the domestic market and foreign market.
3. Setting up production and other physical facilities on a consi-deration of global business, irrespective of natural considerations.
4. Developing products for global markets.
5. Global sourcing of factors of production.
6. Global orientation of organisational structure and management culture.

9.2 Essential Conditions for Globalisation

Following are the essential conditions for a successfull globalisation:

1. Business Freedom: - There should not be unnecessary restrictions on carrying on business. The restrictions on imports-exports, capital flows, other flow of factors from abroad should be done away with. Economic liberalisation is regarded as a first step towards facilitating globalisation.
2. Availability of Facilities: - The availability of facilities at home are essential for enabling a firm to develop globally. Infrastructure needed for the growth of industrial undertaking should be available for expanding capacities.
3. Resources: - The resources required for the development of a firm include finance, technology, managerial expertise, R&D capabilities, company and brand image, human resources etc. Resources are essential for deciding the capability of a firm going global.
4. Government Support: - Government support is essential to encourage globalisation. This support may take the form of policy and procedural reforms, development of infrastructures, R and D support, financial market reforms and so on.
5. Competitiveness: - A competitive advantage is essential for the success of a firm in a global market. If the firm is able to have some advantage as compared to others then it will be able to attract market. The advantage may be in form of low costs and price, product quality, product differentiation, technological superiority, after sale service, marketing strength etc. Even a small firm may have an edge over others in certain aspects.

9.3 Benefits of Globalisation:

Globalisation has revolutionised markets in every country. The developing and developed countries are benefitting under the free economy system. Some of the benefits of globalisation are as follows:

1. Many countries are able to attract foreign capital. The entry of foreign capital has increased the development pace in those countries. China is a unique example, it has attracted maximum foreign capital in the last some years and it has become an industrially developed country.

2. The introduction of better technology has helped in increasing productivity in the host countries. Better technology has also helped in reducing costs of production and making goods available at affordable prices.

3. The increase in competition has made the companies cost and quality conscious. Indian companies never bothered to improve quality and control costs when working under protective system and now they are adopting everything which may make them competitive.

4. The free flow of foreign products into the markets has helped the consumer in buying better and reasonably priced goods. The consumer has benefitted the most from globalisation.

5. Globalisation has helped in spending more on research and development areas. The better and innovative products will attract more market.

6. Globalisation opens up enormous domestic and global opportunities for firms in developing countries.

7. The flow of direct foreign investments has helped in reducing interest rates. India had excessively high interest rates earlier and now these have been brought to reasonable levels. High interest rates add up to the cost of production.

8. Global competition and imports keep a lid on prices, so inflation is less likely to derail the economic growth.

9. Developing countries also have a fair chance to benefit from international trade. Indian companies are now capturing new markets in foreign countries.

9.4 Adverse Effects of Globalisation:

Some of the adverse effects of globalisation are as follows:

1. There is a fear ofloss of jobs when industries or some of the industrial activities shift to other countries due to certain advantages there. American industries have outsourced many activities to outside countries including India. It has resulted in the loss of jobs in America. The imports from outside countries may also adversely affect the industrial production in the country causing loss of jobs.

2. The companies operating under competitve conditions are adversely affected. There may be loss of production and ultimately loss of jobs.

3. The countries depending upon imports may have adverse impact on working conditions of workers. The employees many resort to pay cuts in order to reduce costs of production.

4. The white collar jobs may be shifted to those countries where salary structures are lower.

5. The entry of multinations in developing countries may not result in economic development of the country. MNCs take up only limited activities in the host countries and enter those industries where margins of profit are higher.

9.5 Globalisation of Indian Economy

In Indian context globalisation means removing constraints and obstacles to the entry of multinational corporations, opening the economy to foreign direct investments in different fields of economic activity. It also means allowing Indians to enter into foreign collaborations and also encouraging them to set up joint ventures abroad. There is an implied transparency in import policy.

Globalisation in India started in late eightees but the real thrust was in 1990-91. Narsimha Rao Government started opening up of Indian economy. There was a servere balance of payments problem. The imports reached all time high but exports were sluggish. There was a problem of foreign exchange even for meeting external debt commitments. India had to pledge gold in England for arranging foreign exchange. New Economic Policy was introduced in 1991 on the behest of World Bank and IMF.

9.6 Impact of Liberalisation, Privatisation and Globalisation (LPG) Policies in Indian Economy:

The following is the list of achievements of the Indian Economy as a result of the policies, of Liberalisation, Privatisation and Globalisation through the New Industrial Policy and a series of economic reforms introduced since 1991.

1. Industries such as telecommunications and software etc. have growth very strong. Infosys was born during the era of liberalisation. The software industry in India has attained international reputation.

2. India could bail out successfully from the economic crisis of 1991.

3. Increased exports (from a growth rate of 9 per cent in 1990-91 to 20 per cent in 2000-01)

4. Decreased imports (from 14.4 per cent in 1990-91 to 7 per cent in 2000-01)

5. Foreign direct investment inflows as a percentage of gross domestic product (GDP) at current market prices has gone up from 0.03 per cent in 1990-91 to 1.0 in 2000-01.

6. Declined ratio of external debt to GDP (from 29 per cent in 1990-91 to 22.3 per cent in 2000-01)

7. Rationalised tax policies and tax structure (for income tax, excise and customs duty)

Clearly, the economic reforms undertaken since 1991 have been for reaching and able to unleash the growth potential of the Indian economy. As a result of reforms, the spirit of entrepreneurship is growing phenomenally as is evident from the growing number of startup companies and foreign collaborations in India.

- **Critical Evaluation of LPG Policies:**

But there is a downside of the LPG Policies.

1. Decline in Purchasing Power: - LPG provides a wide choice to the Indian consumer in terms of quality and variety. But the purchasing power of the average consumer has declined.

2. Declining Personal Savings: - With a variety of goods and services dumped by multinationals, the consumption expenditure of the people of India has gone up during the lastdecade. But the savings rate has declined.

3. Increasing Sickness in Industry: - The loss of business to multinationals increased the rate of sickness among the Indian industries.

4. Unfavourable Government Policies: - Imports are allowed in the areas reserved for the small-scale sector whereas Indian entrepreneurs are not allowed to produce in those areas.

5. Disguised Protection: - Social clauses, such as child labour, are being used to beat India, particularly where Indian products are cost effective and of comparable quality.

6. Disappearing Competitive Edge: - Most business firms in the domestic industry lost their competitive capability due to factors such as diseconomies of scale, outdated technology, patronage from the government, excessive rates of interest on loans and taxation etc.

9.7 Multinational Corporations:

Concentration of economic power in a few hands is no longer a national phenomena. It is now visible at international level also. The dependence of countries on each other for both capital and consumer goods has created an international market. The international gaints of developed countries are entering in under developed and developing countries to participate in their business activities. The multinational corporations (MNC's) are trying to influence business activities in other countries. The enterprises of industrially backward countries do not have the capacity to match financial and technical resources of MNC's. This is leading to the elimination of weaker units and the monopoly of bigger units. It is leading to economic concentration at international level.

- **Meaning:**

U.N.O. has defined multinational corporations as ***"Enterprises which own or control production or service facilities outside the country in which they are based."***

In the words of **W.H.Moreland,** ***"Multinational corporations or companies are those enterprises whose management, ownership and controls are spread in more than one foreign country."***

A multinational corporation may be defined as a company or an enterprise which operates in a number of countries and which have production and service facilities outside the country of its origin. Such companies are also called super national or transnational companies/corporations. These companies make decisions in global context. It means the decisions are taken outside the country.

Multinational corporations started about 25 years ago, have spread their operations all over the world. U.S.A., has the maximum number of multinational corporations in the world. Some specialise in selected products only while others take up varied products. In India MNC's operate in fields such as : chemicals, electrical machinery, aluminium, metal and its products, pharmaceutical, heavy engeneering goods, consumer goods, etc. IBM of USA, Philips, Unilever Ltd., Du Pont, Siemans, Imperial Chemical industries are some of the examples of multinationals.

9.8 Methods of Operations:

Multinational corporations operate in the following ways :

1. <u>Subsidary Companies</u>: - MNC's may operate by forming subsidiary companies in the countries in which they want to enter. The main company holds more than half of the shares and other shares are sold to the public. A multinational company controls the formation of Board of Directors. The policies of the holding company are pursued by the subsidiary. Multinationals start subsidiary companies in different countries and keep their control in its own hands. This is an effective method of spreading business interests all over the world.

2. <u>Branches</u>: - Multinational companies can spread their business interests by opening their branches in different countries. The branches work under the directions of the head office. The branch strictly follows the guidelines given by the head office. All the policies to be pursued at branch are decided by the head office. The laws of the country in which the branch is located are to be obeyed. In India if the head office of a branch is situated in some other country then it is known as foreign branch. Operating through branches is an easiest method followed by multinationals.

3. <u>Joint Venture Companies</u>: - In this method of operation multinationals from jiont venture with some company in the country in which they have to extend their business. The Joint Venture can be for producing a product, it may be for marketing the products of the multinational, etc. Generally the multinationals have Joint Ventures for producing those very products in which they have already specialised.

The technical know how and managerial experts is supplied by the multinational and day to day operations are left to the co-venture company. Maruthi udyog is a best example of a Joint Venture set up by the automobiles. Both the co-ventures participate in equity and share profits of the project. Before liberalisation in India, foreign companies could enter Indian markets through Joint Venture only. At present foreign companies have more freedom to operate in India.

4. Franchise Holders: - Under this system, a multinational company gives a licence for allowing the manufacture of some product to an enterprise in other country. The concern getting the license will have to work under the provisions of the franchise agreement. The company giving the franchise right is compensated by paying a periodical amount of royalty or paying in some other mutually acceptable form. The franchise holder cannot violate the terms of the agreement otherwise this facility may be terminated. Such agreements are generally done for those products which are popular in other markets and a demand exists in the country of the franchise holder.

5. Turn Key Projects: - In some cases multinationals are assigned to complete important projects from the very begining. Such projects are in the area in which these corporations have technical expertise. These projects are undertaken by the personnel of the corporations. The developing countries do not have technical expertise in many areas. Since development of those areas is important, such projects are given to multinational companies.

9.9 Benefits of Multinational Corporations:

Multinational corporations have helped the development of host countries by bringing capital and technology which was badly needed there. These corporations have helped both trade and industry . Some of the benefits of these corporations are discussed as follows:

1. Supplementing Capital: - The developing and under developed countries are unable to raise sufficient capital required for their economic development. Their slow growth is mainly due to the inadequate capital formation. Multinationals have vast resources at their command. These corporations set up subsidiary companies or enter into Joint Ventures in host countries. The capital resources of host countries are supplemented by multinationals.
2. Transfer of Technology: - Developing countries have not been able to spend much resources on development. They have not been able to cope with the technological and marketing improvements experienced by developed nations. They use outdated methods of production. The products of these countries are not able to stand in the world market. The multinationals on the other hand, employ latest technology and marketing techniques. They spend regularly on research and development prorammes. It is with the help of multinational corporations that developing countries are able to employ latest methods of production. The multinationals transfer technology through Joint Venture Projects. Mul-tinationals get vast markets and cheap labour in developing countries. The corporations not only capture the markets in host countries but also export goods to other countries. The host country gets better technology of other countries. The host country gets better technology and multinational corporations increase their profits by entering developing countries.

3. Philip to Domestic Industries: - The domestic industries in host countries are benefitted by the collaboration of multinational corporations. The domestic industries are able to use the resources, technology and managerial skill of the multinationals. The quality of their products improves and with the help of collaborators these enterprises are able to enter even the foreign markets. The foreign exchange problems are also solved with the help of multinationals. The domestic industries expand their activities profitability and also improve with the co-operation of multinationals, domestic industries are able to improve their overall performance.

4. Lower Cost of Production: - The cost of production is linked with a number of factors including scale of operations. Multinationals run units on large scale and it brings economies in labour, materials, production etc. Such units are able to control costs and produce goods at cheap rates. The lower cost of production has benefitted the enterprises as well as consumers. The sophisticated production techniques and innovative markets have helped developing countries in lowering cost of production.

5. Creating Employment Opportunities: - The employement opportunities are created under production and marketing activities. Increase in scale of operations increases more job opportunities even though sophisticated technology is employed by multinationals. There are new opportunities in market field also. More and more persons are engaged in handling goods. Besides direct employment, there are indirect employment opportunities also. The entry of multinationals helps in creating employment opportunities in developing countries.

   The acceptability of products in both national and international markets helps in increasing the scale of operations. So job opportunities are created even in those countries where these products are sent.

6. Improving Balance of Trade: - Developing countries suffer from the adverse balance of trade because they import more goods than they export. The import from these countries are not acceptable due to high prices and low quality of products. Since multinationals bring same technology of production which is used by developed countries so the products become competitive in international markets. The products which were earlier important will now be produced in the country and on the other hand exports increase due to facourable prices and proper quality. Under these conditions the balance of trade will certainly improve.

7. Research and Development Activity: - Developing countries lack investment in research and development areas. Multinationals can survive in the international markets only if the they spend some of their resources in these activities. Even though these companies would like to confine most of their research activities to the country of their origin but still business partners are benefitted directly as well as indirectly. These companies spend some part of their research budget in developing countries. Secondly the new improvements in their methods of work will help host countries also.

- **Benefits in Indian Context or Growth Factors in India:**

Multinationals are entering India in a big way in the last some years. The liberalised economic environment has helped the entry of many multinationals into the country in one form or the other. Some companies have started their subsidearies, some have made Joint ventures while some are taking important projects. Indian business is helped in the following ways:

1. Multinationals are bringing more and more capital into the country. It is supplementing the efforts of Indian business.

2. These corporations are bringing better technology by entering into Joint Ventures. Multinationals have entered both capital and consumer goods industries.

3. Indian industry is facing a lot of competition from multinationals. The domestic industry has started improving the quality of their products so that consumer is not reluctant to buy their products. This is a blessing in disguise. Industry has not been caring for the liking of the consumer. But now it will have to compete with multinationals and either there is an improvements or face closure.

4. Foreign companies are taking up many projects in India in the infrastructural area which have earlier been neglected. Many power projects are being set up by multinationals. An improvement in infrastructure will help growth in the country.

5. The inputs in India are very cheap. The agricultural output forming raw materials content and abundance of labour have attracted multinationals to meet their international commitments while producing in India. This will increase exports from India and a favourable balance of trade will emerge in due course of time.

6. The foreign exchange needs of Indian industry are met by multinationals. It helps in importing better technology and also enables expansion and diversification of production activities.

9.10 Disadvantages of Multinationals:

Multinationals have plus and minus points. These corporations have adverse impact on some area of the host country. Some of these disadvantages are discussed as such.

1. Harmful for Producers: - The entry of multinationals is harmful to producers of host countries. These corporations are in a position to sell goods at cheaper rates. The small units are eliminated because they cannot withstand the competition of bigger companies. Multinationals try to take over the business of competitors too. In India Coca Cola company has taken over Parle group of companies producing Limca, Thumps up etc. Similarly, an MNC has taken over Mahrotras, companies manufacturing Shaving blades. The companies offer fabulous prices and lure competitors to sell their units. Once they eliminate competitors, they are in position to exploit markets to their advantage. So multinationals are against the interest of producers in a developing country.

2. Harmful to Consumers: - The consumers suffer at the hands of multinationals. These companies try to create monopoly situation by eliminating other producers in the market. On the basis of financial strength, excessive advertising, aggressive marketing

these companies attract consumers towards their products. Once the competitors are eliminated then multinationals start exploiting consumers by raising prices and lowering the quality of products. The aim of these companies is to increase profits and they try to achieve it by any means.

Multinationals enter in those products where scope of profits is more. They produce goods for higher income group people because margin of profit is more in these products. These companies do not have the interest of consumers in mind but are worried to increase their profits. They use all such measures which help them to increase their profitability.

3. Bad Business Ethics: - Multinationals indulge in bad business ethics too. In the beginning they send manufactured goods from the countries of their origin and market them in host countries by just pecking them there. They try to delay the transfer of technology so that their own products are dumped there. These companies also try to manipulate the laws of the land to suit their objectives.

4. Currency Manipulations: - Multinationals try to use their foreign currency reserves in such a way that they increase their profits. These companies, being internationals, try to build reserves in countries with strong currencies and raise loans where currencies are weak. Instead of helping host countries in lasting their currency problems, these companies rather accentuate this problem by accumulating large currencies.

5. Political Dominance: - Multinationals concentrate economic power in their hands. Through this power they try to dominate the political decisions of host countries. The countries which are dependent for economic help on big countries cannot take political decisions without the wishes of their masters. East India Company entered India as a trading company and then ruled this country for centuries, such tactics are tried even at present.

9.11 Role of Multinationals in Industrial Development:

The role of multinationals in industrial development can be discussed under four heads.

a) Economic development.
b) Social development.
c) Market development.
d) Infrastructure development.

As summarised in the following tables. These are discussed below in detail.

TABLE - 1

ECONOMIC DEVELOPMENT	SOCIAL DEVELOPMENT	MARKET DEVELOPMENT	INFRASTRUCTURAL DEVELOPMENT
HUGE FINANCES	INCREASE EMPLOYMENT POTENTIAL	CUSTOMISED PRODUCTS AND SERVICES	SUPERIOR TECHNOLOGIES
LOWER COSTS	ENHANCES STANDARD OF LIVING	DEMAND CREATION	RESEARCH AND DEVELOPMENT
OPTIMUM UTILISATION OF LOCAL RESOURCES	BETTER WORK CULTURE	CUSTOMES THE ULTI-MATE BENEFICIARY	TRAINING AND DEVELOPMENT
	MOBILITY OF HUMAN CAPITAL	EXPANDED MARKET TERRITORIES	LATEST MANAGEMENT TECH-NIQUES
		MARKET STRATEGIES	DEVELOPMENT OF RE-GION AS NUB
		DEVELOPMENT OF RURAL MARKETS	

Dr.M.Vijaya Lakshmi.

LESSON - 10

SMALL SCALE INDUSTRIES

10.0 Objectives :-

A careful study of this chapter will enable you to understand the :

* Meaning of Small Scale Industry.
* Importance / Role of Small Scale Industries.
* Government Measures for Small Scale Sector.
* New Small Scale Sector Industries Policy, 1991.
* Prospects of Small Industry.
* Suggestions for Improving the working of Small Business.
* Policy Initiatives during 2004-05.

Structure

10.1 Introduction :

Small business Plays an important role in the development of every country in a developing country like India. Therefore, this sector is indispensable. Since independence small business sector consisting of small scale tiny units, cottage and rural industry have made significant progress. In the spheres of employment and production, this sector provides a major share.

Small business is now producing a wide range of commodities from ordinary consumer goods to sophisticated goods based on the most modern technology like electronic goods, television sets etc.

CLASSIFICATION OF INDUSTRIES :

Industries in India have been classified in the following four parts :

1. Village or Cottage or Rural Industries.
2. Small Scale Industries.
3. Medium Scale Industries.
4. Large Scale Industries.

10.2 MEANING OF SMALL SCALE INDUSTRY :

Small scale industries were defined on different basis but since March 1, 1999, small industries include all those units having a fixed capital of Rs. 1 Crore invested therein. It was previously Rs. 3 crore. Industries with a fixed capital of Rs. 25 lakh (Earlier Rs. 50 lakh) are calling Tiny Industries. Small scale industry employes hired labour and machines and power are used. Scientific instruments industry in Ambala, Carpet manufacturing industry in Panipat, Hosiery industry at Ludhiana, T. V. Manufacturing units in Delhi are some of the examples of small scale industries.

10.3 IMPORTANCE/ROLE OF SMALL SCALE INDUSTRIES :

Small scale and cottage industries have been playing an important role in Indian economy in terms of employment generation and growth.

1. Employment Generation :

Small business sector is labour intensive and is generating huge employment opportunities. According to Planning Commission, 519 lakh persons are getting employment from small and cottage industries.

2. Production :

Small scale sector is contributing 49 percent of the total industrial production in India. There is a large scope of increasing production in the small scale sector. By making proper and efficient use of available resources in rural areas, small scale business can make a major contribution in total production of the country.

3. Equal Distribution of National Income :

An important role played by small sector in the national context is that it ensures more equitable distribution of national income and wealth.

4. Efficiency of Small Scale Industries:

A number of studies have revealed that small scale sector has tremendously improved its efficiency. It has been proved that the small scale factory combined the largest number of workers with a rupee's worth of fixed capital; that a rupee worth of fixed assets produced almost seven times an output in small as compared to large industries and that the value added by a rupee worth of fixed investment in small factories was atleast three times as large as that of a large factory.

5. <u>Lessening of Pressure on Agriculture</u> :

Indian economy is based on agriculture. About 70 percent persons are engaged in agriculture profession. The land holding being small there is disguised underemployment. Agricultural sector cannot sustain the population of rural areas.

6. <u>Use of Local Resources</u> :

Small industries make use of those local resources which would have remained unused for want of such industries. These resources may not be required for large scale industries. For example, small industries encourage many people to become
entrepreneurs and these persons contribute greatly in the economic development of the country.

7. <u>Regional Dispersal of Industries</u> :

Small scale and Cottage industries are playing an important role in dispersing the industrial units of the country in various parts of the country. While large scale units try to be near big cities, small business benefits by going to rural areas. The availability of cheap land and labour in rural areas encourages small sector to shift to these places.

8. <u>Encouragement to Cooperation</u> :

These industries encourage co-operative efforts of rural people for starting small units. Such co-operatives make use of resources available at rural areas and encourage people to invest their small savings in such ventures.

9. <u>Suitable for Underdeveloped Areas</u> :

Most of the products of these industries may be consumed at nearby areas and inputs may also be available at cheap rates. The development of underdeveloped areas helps in balancing the overall growth.

10.4 PROBLEMS OF SMALL BUSINESS IN INDIA :

1. <u>Problem of Finance and Credit</u> :

The scarcity of finance and credit is the main problem faced by small business. The capital base of small industrial units is usually very weak since they generally have partnership or single ownership. Banks and other financial institutions are hesitant to extend loan facilities to small units since they cannot offer securities for such loans. These units also fail to get credit facilities for purchasing their inputs.

2. <u>Problem of Raw Materials and Power</u> :

Small business units do not get adequate raw materials. Small scale industries contribute significantly to the export earnings but still they do not get sufficient imports of raw materials.

3. <u>Problems of Marketing</u> :

These industries face lot of problems in marketing their products. These units often do not possess any marketing organisation and consequently their products compete unfavourably with the quality of products of large scale industries. These industries can ill afford to bear advertisement and publicity costs. Marketing problems of small business are having adverse impact on their profitability.

4. <u>High Production Costs</u> :

Costs of production are very high in these industries. It is due to the high cost of production and old methods of production and higher fixed costs due to small size that these industries fail to compete with large scale units.

5. <u>Old Methods of Production</u> :

Small Scale sector generally uses old methods of production. Old tools and equipment are still in use in handloom industry. The machines used in many small industries have gone obsolete. These units often ignore the changing tastes and fashions of the people.

6. <u>Problem of Sickness</u> :

In India, 38.6 percent small scale industries are sick. The sick units are running under losses. These units are not able to plan their working capital needs in advance. The commercial banks advance loans for small periods. The banks and financial institutions go on adding penal interests to their loan accounts, hence forcing these units to go sick and then close down.

7. <u>Competition with Large Scale Industries</u> :

Another problem faced by these units is that they have to face competition from large scale industries. The products of large scale industries are comparatively of better quality and are cheap. So these units are not able to compete with large scale units.

8. <u>Lack of Demand</u> :

The small scale and cottage sector mainly concentrates on the production of traditional and artistic goods. These goods are not much in demand. On the contrary, the demand for luxuries is rapidly increasing. In order to attract demand, the small scale sector will have to plan their activities as per the needs of the market and preferences of consumers.

9. <u>Lack of Standardisation</u> :

There is no standardisation of finished goods. For want of classification, the producers don't get fair prices for their products.

10. <u>Infrastructural Constraints</u> :

Small scale business is suffering from infrastructural constraints. The cottage and tiny industrial units are mainly situated in rural areas. These areas are not properly connected by railways and roads. The entrepreneurs find problems in bringing the raw materials from outside and in sending finished goods to markets.

11. <u>Lack of Advertisement</u> :

Owners of small business do not have resources for advertisement. Due to lack of advertisement demand for goods is low. The finished goods of this sector do not attract sufficient clientele.

10.5 GOVERNMENT MEASURES FOR SMALL SCALE SECTOR :

Recenlty, the approach of government towards cottage and small industries has undergone a sea change. A number of measures have been taken for the development of this sector.

1. <u>Institutional Arrangements</u> :

The government has established a number of institutions and boards to provide help for the development of small scale sector. Small Scale Industries Development Organisation has been set up at the centre. The head of this organisation is known as Development Commissioner. All India Small Industries Board has also been established under the chairmanship of Union Industries Minister. The Ministry of Industries has also set up a separate Department of Small Scale Agro and Rural Industries. The main objective of these organisations is to see the problems of small industries and take remedial measures.

A number of boards and corporations have been set up at central and state levels for the help and development of small sector. Some important institutions are (i) The Cottage Industries Board (ii) The National Small Industries Corporation (iii) Khadi and Village Industries Board (iv) Central Marketing Institute (v) National Design Institute (vi) District Industries Centres (vii) State Financial Corporations (viii) Regional Training Centres (ix) All India Handloom and Handicraft Board. All these institutions constitute a sort of infrastructure for the promotion of small scale and cottage industries.

2. <u>Financial Help</u> :

Several measures have been taken to help small sector in getting financial help on easy terms. State financial corporations have been set up in all states and Union Territories especially to help small sector. Regional Rural Banks and State Co-operation Banks have also been set up under the directions and guidelines of Reserve Bank of India, R.B.I. also launched “credit guarantee scheme” in order to guarantee the loans given to small industries. Consequently various banks and other financial institutions have started giving loans to these industries more liberally at low rates of interest.

3. <u>District Industries Centres</u> :

In order to provide assistance to entrepreneurs on matters like licensing, finance and marketing at one place, the government set up in 1978, District Industries Centres in 460 districts of the country. The main functions assigned to these centres are : (i) conduct survey of available raw material and other resources (ii) arrange raw materials for industry (iii) supply machines (iv) arrange facilities for marketing of products (v) arrange loans (vi) ensure quality products (vii) establish research and reaction cell in each district. The centre will help in the development of small sector through these centres.

4. <u>Industrial Estates</u> :

In order to give a philip to small scale industries government sets up industrial estates. The land is acquired by the government and then it is developed from industries point of view. Arrangements are made for sewer, water, electricity etc. The developed premises are sold to small entrepreneurs on easy installments. At present there are about 662 industrial estates in India.

5. <u>Tax Concessions</u> :

Small and cottage industries are exempted from many taxes which are otherwise imposed on large scale units. Tax concessions and benefits help these units in using this money for development.

6. Marketing Facilities :

Special efforts are made to market the products of these industries. In order to sell the goods produced by these industries 190 emporia and shops have been opened throughout the country. Central Cottage Industries Emporia tries to promote the sale of goods of small sector. National Small Industries Corporation also arranges for the sale of these goods.

7. Small Industries Development Bank of India (SIDBI) :

SIDBI was set up as an apex body at the national level for promotion, financing and development of industries in the small scale sector. SIDBI is launching various promotional and development activities in the country. Rural industrialisation is one of the thrust areas in the promotional activities of the bank

8. Facilitative Measures :

Some other measures taken by the government for the development of small sector are as follows :

(a) Alloting land on easy terms to small units.

(b) Procurement of plant and mechinery for small-scale manufacturers on hire-purchase basis on concessional terms.

(c) Simplification of procedural formalities for obtaining import licence.

(d) Duty exemption in certain cases to such units.

10.6 NEW SMALL SCALE SECTOR INDUSTRIAL POLICY, 1991 :

The Government of India announced its new policy towards small sector on August 6, 1991. The primary objective of this new policy is to impart more vitality and growth impetus to this sector in order to attain a higher growth rate in respect of its output, employment and exports. The following are the main features of this new policy :

(i) Enhancement of the investment limit in case of 'tiny' enterprises to Rs. 5 lakhs from Rs. 2 lakhs, irrespective of the location of the unit. This limit is raised to Rs. 25 lakh in 1997.

(ii) Widening the scope of small scale industries by including industry related services and business enterprises.

(iii) To allow equity participation by other industrial undertakings in the small scale units, not exceeding 24 per cent of the total shareholding so as to provide SSI units an access to the capital markets and to encourage modernisation.

(iv) Introduction of a new legal form of organisation of business, namely restricted or limited partnership. In this form the liability of atleast one partner is unlimited while other partners can have limited liability. This provision will attract equity capital from friends and relatives of the small scale enterpreneurs.

(v) Arranging adequate and regular flow of credit on a normative basis and to improve the quality of its availability for the SSI units.

(vi) Establishing of a special monitoring agency to look after the genuine credit needs of the small scale industrial sector.

The Reserve Bank of India has announced a special package of measures on April 17, 1993 to ensure adequate and timely credit to small scale sector. According to this package :

(i) Banks should give preference to village industries, tiny industries and other small-scale in that order, while meeting the credit requirements of the small scale sector.

(ii) The banks should step up the credit flow to meet the legitimate requirements of the small sector in full during the Eighth Five Year Plan.

(iii) Banks should adopt single window clearance scheme of Small Industries Development Bank of India (SIDBI) for meeting the credit requirement of small scale units.

(iv) An effective grievance redressal machinery to be set up within each bank of small scale sector.

10.7 PROSPECTS OF SMALL INDUSTRY :

1. Potential for Employment :

Small Scale sector has great potential for employment. This sector is labour intensive and at present employs nearly 19 million people. India is facing unemployment problem. The higher growth rate of population will add more persons to the labour market. The small scale sector will create more and more job opportunities. It also provides self employment to large number of persons.

2. Contribution of GDP :

Small scale sector greatly contributes to gross domestic product. At present over 60 per cent of GDP is coming from this sector. Small scale sector has entered every type of industry.

3. Lower Investments :

A small scale enterprise can be set up with lower investments. A tiny unit can be started at home even, it can later develop into a moderate unit. Small entrepreneurs can make use of their technical knowledge by setting up a small unit with their limited returns. This sector has great potential since units can be set up with limited resources.

4. Dispersal of Income :

The income generated by small scale sector is distributed among large number of persons while income generated by large sector goes to few persons only. Small sector helps in reducing concentration of economic power. Small enterprises bring about greater equality of income distribution.

5. Balanced Regional Development :

Small scale units help in balanced regional development. Since these units can be set up with small resources, these are widely spread all over the country. These units are planned as per the available inputs and resources. The rural areas, semi-urban areas, far flung areas, all have small scale units to cater to the local or regional needs. On the other hand, large scale units are normally set up in metropolitan and big cities where all types of facilities are readily available. The decentralisation of industrial enterprises also helps to tap local resources such as raw materials, idle savings, local talents etc. Decentralisation helps to solve the problems of congestion in the few industrial towns by enlarging the area of employment.

6. <u>Higher Degree of Flexibility</u> :

There is higher degree of flexibility in small sector units. There is a possibility of change in operations, if need be, methods of production can be changed, scale of work can be adjusted etc. All these changes can be possible in a small scale sector only. A change in operations of a large scale unit will mean huge costs. Even the shifting of a small scale unit may be possible at a lower cost.

7. <u>Less industrial Disputes</u> :

Industrial disputes become the cause of failure of many enterprises. Large scale units have more industrial disputes as compared to small units. There are two reasons for it : One reason is that large scale units have professional trade leaders who always try to interfere in the working of the units whereas small units generally do not have trade union units. Secondly there is a direct relationship between the owner and the workers in small units.

10.8 SUGGESTIONS FOR IMPROVING THE WORKING OF SMALL BUSINESS :

Small scale units are facing a number of problems and their urgent redressal is required for their survival. Following are some of the suggestions for tackling the problems faced by these units :

1. <u>Supply of Raw Material</u> :

Efforts should be made to supply raw materials to small units. These units should be given quotas of raw materials as per their installed capacities as is done in the case of large scale units. They should also be allocated foreign exchange for importing raw materials as per their requirements.

2. <u>Credit Facilities</u> :

Small scale units are not able to furnish securities and guarantees for taking loans from banks and other institutions. The banks should give loans to these industries on the basis of their potential credit worthiness. Financial institutions should be liberal in extending loans to these industries.

3. <u>Marketing Facilities</u>:

It is necessary that goods produced by small scale units are sold at the earliest and at remunerative prices. Government should establish a centralised marketing agency for helping these units in marketing their products.

4. <u>Improving Methods of Production</u> :

These industries should make use of new production techniques and latest equipments. Government agencies should supply latest machines and equipment to these units on Hire-Purchase basis. Research should be undertaken to find out better methods of production.

5. <u>Proper Training</u> :

The persons working in small scale sector are not properly trained. Generally, they learn by doing. The limited knowledge of work does not help them in adopting to newer and better methods of work. There should be training facilities for workers. Industrial Extension Centres should be established to provide services and technical information about these industries.

6. <u>Quality Control Measures</u> :

Small Scale sector should be asked to follow standard quality centred measures. The standards should be fixed for the goods produced by this sector. The consumers will be more attracted to buy those goods which have proper quality standards.

7. <u>Publicity and Exhibitions</u> :

In order to make the products of small scale sector more popular, extensive publicity through exhibitions and trade fares is needed both in side the country as well as in foreign countries.

8. <u>Research</u> :

In order to improve the quality of goods, lowering their cost of production, introducing new products, bringing the technical efficiency, there is a need for setting up research centres.

9. <u>Government Help</u> :

Government should help this sector through fiscal and monetary policies. This sector should be given tax incentives for expanding the work, loans should be extended on lower rates without requiring security etc. This sector should also be given a special care under Five Year Planning System.

10.8.1 SPECIAL MEASURES AND INCENTIVES FOR SMALL SCALE SECTOR :

The Small scale sector has been suffering from financial constraints. Reserve Bank of India announced a special package for this sector in July, 1993. The main features of this package were :

(i) Banks should give preference to village industries, tiny industries and other small scale units in that order, while meeting the credit requirements of small scale sector ;

(ii) The banks should step up the credit flow to meet the legitimate requirements of SSI sector in full during Eight Five Year Plan ;

(iii) An effective grievance redressed machinery within each bank which can be approached by the SSI in case of difficulties would be set up ; and

(iv) Bank should adopt the single window clearance scheme of SIDBI for meeting the credit requirements of small scale units.

10.9 POLICY INITIATIVES DURING 2004-05 :

Following measures were taken during 2004-05 for the further development small scale sector.

1. National Commission on Enterprises is Unorganised / Informal Sector was set up to recommend measures for the improvement of productivity, generation of employment, infrastructural development, technology upgradation etc.
2. The number of reserved items for this sector increased to 605.

3. To facilitate technology upgradation and enhancing competitiveness, the investment limit has been raised from Rs. 1 Crore to Rs. 5 Crore in respect of 7 items of sports goods.

4. The Small and Medium Enterprises Fund to Rs. 10,000 crore was operationalised by SIDBI since April, 2004. Eighty per cent of lending from this fund will be for SSI units at interest rate of 2 per cent below the prevailing prime lending rate of SIDBI.

Reserve Bank of India enhanced the composite limit to Rs. 1 crore from Rs. 50 lakh.

10.10 REFERENCE BOOKS :

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Dr. M. VIJAYA LAKSHMI

LESSON - 11

INDUSTRIAL FINANCE

11.0 Objectives:

After studying this lesson you should be able to understand the following:

- → Importance of Industrial Finance
- → Types of Industrial Finance
- → Long term capital Vs short term finance
- → Fixed Captial
- → Working Capital
- → Under Capitalisation
- → Over Capitalisation

Structure

11.1 Introduction

11.2 Industrial Finance

11.2.1 Factors Influencing Industrial Finance

11.3 Need for Capital

11.4 Types of Capital

11.4.1 Fixed Capital

11.4.2 Working Capital

11.4.3 Features of Working Capital

11.4.4 Working Capital Cycle

11.4.5 Factors Determining Working Capital Cycles

11.5 Capitalisation

11.5.1 Importance of Capitalisation

11.6 Theories of Capitalisation

11.6.1 Cost Theory

11.6.2 Earnings Theory

11.7 Under-capitalisation

11.7.1 Advantages

11.1 Introduction:

Finance forms the base for any business. Every business, irrespective of size, requires proper management of its finances. It is essential to understand the concept of finance function, how finance is planned, sources of short-term and long-term finances and the factors determining financial requirements.

Capital structure explains the composition of long-term capital of a business organisation. It refers to the firms' long-term debt and equity. Capital structure covers long term capital, short term capital, over capitalisation, under capitalisation.

11.2 Industrial Finance:

Finance is the life blood of any industrial or commercial undertaking. It is needed for starting the business and also to keep it going. If it is sole proprietorship or partnership, the problems of finance are not very complicated and generally the capital comes from the individuals directly running the business. If business activities are run on a large scale, the time that elapses between production and consumption is considerably long. This has increased considerably the importance of finance and now, among the factors of production, finance occupies a prominent position. Since the large industries take the form of companies, the problems of modern business finance are for all practical purposes the problems of corporate finance. Finance is the science and art of raising and utilising funds effectively and efficiently in the management of a business.

11.2.1 Factors Influencing Industrial Finance:

Industrial finance is required in industries for the following purposes.

1. <u>Fixed assets</u>: - To purchase fixed assets such as land and buildings, plant and machin ery, furniture, vehicles etc., finance is needed.

2. <u>Current assets</u>: - Material, cash to pay Debtors, wages also need finance.

3. Preliminary expenses: - Expenses required to establish company are known as prelimi nary expenses. For example expenses of market survey, remuneration to promoters, legal expenses etc.

4. Expenses to collect capital: - Expenses to collect capital such as Under-writting Comission, Brokerage, advertisement also require finance.

11.3 Need for Capital:

A business needs capital to:

1. Promote a business: - Capital is required to promote a venture. Huge expenses have to be incurred on project reports, feasibility studies, preparation and filing of various documents, and for meeting various other expenses in connection with raising capital from the public.

2. Conduct business smoothly: - Business firms also need capital for the purpose of con ducting their operations such as reaserch and development, advertising, sales promotion, distribution and operating expenses.

3. Expand and diversify: - Firms require capital for expansion and diversification. This in cludes development expense such as purchase of sophisticated machinery and equip ment and also expenditure on sophisticated technology.

4. Meet contingencies: - Firms need funds to meet contingencies such as a sudden fall in sales, major litigation (legal cases) and natural calamities like fire etc.

5. Pay taxes: - Firms have to meet their statutory commitments such as income tax and sales tax, excise duty etc.

6. Pay dividends and interest: - Firms have to make payment towards dividends and interest to their shareholders and financial institutions respectively.

7. Replace assets: - Businesses need to replace their assets like plant and machinery after a certain period of use. For this they need funds to replace old and wornout assets.

8. Support welfare programmes: - Companies may also have/like to take up social welfare pro-grammes such as literacy drive, health camps etc. They may have to donate to chari table trusts, educational institutions or public service organisations.

9. To wind up: - Companies may need funds to meet the liquidation expenses.

11.4 Types of Capital:

Capital can broadly be divided into two types such as fixed and working.

11.4.1 Fixed Capital:

Fixed capital: - Fixed capital is that portion of the capital which is invested in acquiring long-term assets such as land and buildings, plant and machinery, furniture and fixtures etc. These assets are not meant for resale. They are intended to generate revenues.

- **Features:**

i) Permanent in nature: - Fixed capital is more or less permanent in nature. It is generally not withdrawn as long as the business is running.

ii) Profit generation: - Fixed capital is a good source of profits. It is not possible to produce goods without effecient plant and machinery which are fixed assets.

iii) Amount of fixed capital: - The fixed capital of a company depends on factors such as size of the company, nature of business, method of production etc.

iv) Utilised for promotion: - Fixed capital becomes very important at the time of promotion and modernisation of the company.

- **Factors Determining Fixed Capital Requirements:**

The following factors govern fixed capital requirement.

1. Nature of business: - Requirement of fixed capital depends upon the nature of business. Public utility concerns such as railways, electricity, road transport require huge amount of capital. Retail business may not require huge amount of capital.

2. Size of business: - The higher the size of business, the higher is the requirement of fixed capital. For example- Tiffin centre require less fixed capital compare to five star hotel.

3. New Technology: - A large amount of fixed capital is required if production is completely automated.

4. Specialised activities: - If the company concentrates only on one activity, it may require small amount of fixed capital. If it engage more than one activity it requires more working capital.

11.4.2 Working Capital:

Working capital is the the life line of business. Working capital is also called circulating capital, it is used to meet regular or recurring needs of business, such as purchase of raw material, payment of wages and salaries, rent, advertisement, power etc., working capital takes the form of cash, near cash and other assets in the process of moving towards the cash form in a short period.

11.4.3 Features of Working Capital:

1. Short life span: - Working capital changes in its form from cash to stock, stock to debtors, debtors to cash.

2. Smooth flow of operations: - Adequate amount of working capital enables the business to run on soundlines.

3. Liquidity: - The assets represented by the working capital can be converted into cash quickly within a short period of time unlike fixed assets.

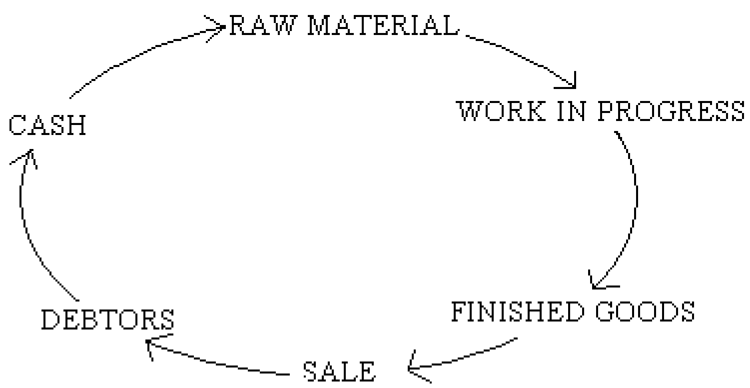
4. Amount of working capital: - The amount of working capital of a business depends on many factors such as size and nature of the business, production policies, marketing policies etc.

5. Payment of current expenses: - Working capital is used to pay for current expenses such as raw materials, payment of wages and salaries etc.

11.4.4 Working Capital Cycle:

The flow of money in the business is referred to as 'Working Capital Cycle' and it is important for the smooth functioning of any business. The money invested in working capital is continuously moving towards purchase of material inputs, wages and salaries and other expenses. In other words raw materials are turned into finished goods which are then sold either for cash or for credit. Cash, after collection is used to purchase raw material, and the process repeats. This process is showed in the following figure.

FIGURE - 1
WORKING CAPITAL CYCLE



11.4.5 Factors Determining the Requirements of Working Capital:

The size of working capital required for the business is determined by a number of factors. They are:-

1. Nature of business: - Manufactring companies requires less working capital when com pared to trading organisations.

2. The length of manufacturing cycle: - Length of manufacturing cycle refers to the time taken from the point of first stage to the last stage of manufacturing. The longer the length of manufacturing process, the higher the requirement of working capital.

3. Terms and conditions of purchase and sale: - If the firm buys raw materials on credit and sells the finished goods in cash, it can manage with lower volume of working capital.

4. Delay in the supply of raw materials: - The more the delay in the supply of raw material the more the need for working capital. Normally, the bottlenecks in the supply of raw materials, force the business to buy small volumes at high prices which end up in a working capital crisis.

5. Fluctuations in the demand: - Seasonal fluctuations are common in most businesses. According to the demand the need of the working capital is determined.

6. Production Policies: - In certain industries the demand is subject to wide fluctuations due to seasonal variations. The production could be kept either steadly by accumulating inven tories during slack periods with a view to meet high demand during the peak season or the production could be curtailed during the slack season and increased during the peak sea son. If the policy is to keep production steady by accumulating inventories it will require higher working capital.

7. Competition: - Where competition is high, the business man is to offer variety of products, allow credit, spend more on advertising. All these require huge amount towards working capital.

8. Profit margin: - If the more profit margin is required the more is the requirement of working capital.

9. Amount of Taxes: - It is necessary to plan for the funds necessary to pay taxes from time to time. If the taxes are high, working capital required to pay the taxes is high.

10. Depreciation policy: - The higher the rate of depreciation the higher the working capital generated from this source. Because it is a book cost and hence does not involve outflow of funds.

11. Dividend policy: - Payment of consistent rates of dividend in time requires more working capital.

12. Price level: - In times of rising prices, the prices of inputs increase. The company has to arrange for a greater volume of working capital.

13. Operating efficiency: - Operating efficiency can be obtained by the strategies such as cost reduction, cost control, waste elimination etc. The higher the degree of operating effi ciency, the lower the volume of working capital and vice versa.

11.5 Capitalisation:

The term capitalisation is derived from the term 'capital'. It refers to the long-term finance available to the company. Long term finance may include own funds and also borrowed funds. Own funds of the long-term nature include equity shares, preference shares and retained earnings. Borrowed funds of the long term nature include debentures, bonds or loans from the financial institutions which carry a fixed rate of interest. Capitalisation explains whether the company has adequate funds to carry out its operations. If the funds are not adequate, the company may not earn the expected profits.

<u>Capital structure</u>: - Capital structure explains the composition of long-term capital of a business organisation. Long term capital include long-term debt and equity.

11.5.1 Importance of Capitalisation:

Most business organisations require huge finances to meet their operating costs. The following points depicts the importance of capitalisations.

1. It is very difficult to imagine the process of production without capital.

2. Capital accumulation and technological advancements are closely related.

3. Capitalisation creates and enhances the level of employment opportunities.

4. It has a strategic role in enhancing productivity.

11.6 Theories of Capitalisation:

There are two theories of capitalisation, viz

A. Cost Theory.

B. Earnings Theory.

11.6.1 Cost Theory:

According to the cost theory, the value of a company is arrived at by adding up the cost of fixed assets, the amount of regular working capital required to run the enterprise, promotion expenses etc. The true value of an enterprise can be judged only by its earnings capacity. The calculation of capitalisation is useful to know the amount of capital to be raised.

11.6.2 Earnings Theory of Capitalisation:

This theory assumes that a business is a profit making entity and is worth what it will earn. Accordingly it states that the true value of an enterprise depends upon its earnings and earning capacity and hence the capitalisation of the concern or its value, is equal to the capitalised value of its estimated earnings. It is advisable for an established company to adopt the earnings theory which would provide a better basis of capitalisation.

11.7 Under-capitalisation:

A company is under-capitalised when its actual capitalisation is lower than its proper capitalisation as warranted by its earning capacity. Such a company will earn considerably more than the prevailing rate on its outstanding securities. Following are the advantages of under capitalisation.

11.7.1 Advantages:

1. Under capitalisation is associated with a high rate of dividend.

2. It is associated with high market value of shares.

3. Under-capitalised company may have large secret reserves.

4. There is a very large appreciation in the value of assets specially of buildings, plant and goodwill.

5. The appreciated assets bring profits and therefore, the profits in such a company would appear to be much larger than are warranted by the book figures of the capital.

11.7.2 Evils of Under-capitalisation:

Under-capitalisation has the following evils.

1. High prices of equity shares lead to their limited market ability.

2. A high rate of earnings per share may encourage potential competitors to enter the market, causing cut-throat competition.

3. High rate of earnings may encourage the workers to demand higher wages.

4. Consumers may also feel that they are being over-charged in order to declare high rate of dividends.

5. Inadequacy of capital may compel a company to borrow funds at a higher rate of interest.

6. It may attract control of Government, and higher taxation.

All or some of these evils may reduce the margins of profit earned by the company.

11.7.3 Causes of Under-capitalisation:

The causes that may lead to under capitalisation are as follows-

1. Under estimation of future earnings: - According to the financial planning if the future earnings prove to be higher than the estimated figure, the company will become under-capitalised.

2. An unforeseable increase in earnings: - A company started during depreciation finds itself to be under-capitalised in the period of recovery or boom.

3. Conservative dividend policy: - It leads to adequate reserves for depreciation and re placements. This would increase the company's earning capacity.

4. High efficiency: - Maintenance of high efficiency results in increased profits and the real value of the company is likely to exceed its book value.

11.7.4 Remedies:

Under-capitalisation can be corrected by measures such as:-

1. Splitting up of shares: - Splitting up of shares to reduce the rate of earnings per share is a remedy to under-capitalisation. By this method the face value of each share is split into shares of smaller denominations. By this method a lesser degree of under-capitalisation can be avoided.

2. The issue of bonus shares: - In case the company has sufficient reserves or surpluses the issue of bonus shares is an easy remedy for under-capitalisation.

3. Increasing the amount of shares and debentures: - Under-capitalisation can also be remedied by increasing the amount of shares and debentures.

4. Increasing the par value of share: - The company may revise upwards the values of assets and new shares with higher par value issued to the share holders. This will lead to decline of the rate of earnings though the amount of dividend per share may not be affected.

11.8 Over-capitalisation:

If a company raises more capital than is warranted by the figure of capitalisation of its earning power, the company will be said to be over-capitalised. In other words, a company is over-capitalised when its actual profits are not sufficient to pay interest and dividends at proper rates. A company is over capitalised only because the existing capital is not effectively utilised with the result that there is a fall in the earning capacity and consequently in the rate of dividend payable to equity shareholders. This usually leads to a decline in the market value of the shares. The following are the causes of over capitalisation.

11.8.1 Causes of Over-capitalisation:

1. <u>Idle funds</u>: - The enterprise may raise more money by issue of shares and debentures than it can profitably use.

2. <u>Borrowings</u>: - If a company borrows a large sum of money and has to pay a rate of interest higher than its rate of earning, the result will be over-capitalisation. A major part of the earnings may be given away to the creditors as interest leaving little for the shareholders.

3. <u>Excessive amount paid to Assets</u>: - Over-capitalisation may often result when an exces sive amount is paid for goodwill and for fixed assets acquired from the vendor company or from promotions or other people associated with the company or when unduly high amounts are spent on establishment.

4. <u>Acquisition of assets during boom period</u>: - If company acquires assets like plants, ma chinery during boom period, the price paid is naturally high, when boom disappears, the real value of assets will decline. Such a company is over-capitalised.

5. <u>Inadequate provision</u>: - If a company does not make sufficient provision for depreciation and replacement and distributes higher rates of profit amongst the shareholders, the com pany will find after some time that, while the book value of assets is high, the real value is extremely low. The efficiency of the company is adversely affected and its earnings go down thus bringing down the market value of the shares. This is yet another case of over capitalisation.

6. <u>High rates of taxes</u>: - High rates of taxation may leave little in the hands of the company to provide for depreciation and replacements and dividend to shareholders. This may ad versely affect its earning capacity and lead to over-capitalisation.

7. <u>Under-estimation</u>: - When the promoters under-estimate the capitalisation rate, the capi talisation may not support the expected rate of earnings and over-capitalisation may result.

11.8.2 Evils of Over-capitalisation:

Over-capitalisation has evil consequences from the point of view of the company, the society and the shareholders.

From the point of view of the company:-

1. <u>Reduction in the rate of dividend</u>: - Over-capitalisation will result in considerable reduction of the rate of dividend on the equity shares issued. This is because the profits have been distributed over large number of shares.
2. <u>Market value of the shares falls</u>: - With the disappearance or reduction of dividends, the market value of the shares falls, and the investors lose confidence in the company.
3. <u>Window dressing</u>: - Sometimes the company reports to questionable practices including window dressing in order to show a respectable figure of profits.
4. <u>Re-organisation</u>: - Re-organisation would again mean considerable loss of goodwill.

From the point of view of society:-

1. Reduced efficiency: - An Over-capitalisation concern is compelled to raise the prices of its products. Due to reduced efficiency it is not able to maintain the quality of its products.
2. Cuts in wages: - An over-capitalisation company may try to raise its profits by effecting cuts in wages of workers.
3. Affect the interests of creditors: - Since a over-capitalisation concerns is unable to com pete with other concerns, it may have to close down. This would effect the interests of the creditors.
4. Misapplication of resources: - Over-capitalised concern results in misapplication of soci ety's resources, because capital in under utilised.
5. Gambling: - The shares of an over-capitalised concern provide scope for gambling on the stock exchange.

From the shareholders point of view:-

1. The shares of an over-capitalised company sell below par in the market.
2. The shareholders have also to suffer due to a low return on their investment.
3. The shares of an over-capitalised company have relatively small value.
4. The low priced shares are subject to speculative gambling.

11.8.3 Remedies:

The following remedial steps may be adopted in case of over-capitalisation of a company.

1. An over-capitalised company must go in for complete re-organisation through redemption of bonds.
2. Over -capitalisation may also be corrected by redemption of preference shares if they carry high dividend rate.
3. Over-capitalisation can be corrected by reducing par value.
4. Reduction in the number of equity shares is also a fine method, provided the shareholders agree to this concept.

11.9 Summary:

In brief the capital refers to the total amount of finances a business requires for its operations, both in the short run and long run. Capital is defined as the wealth created over a period of time by not spending. Business firms require capital for various reasons, say to purchase fixed assets and to run the business. Thus the capital is divided into two categories, Fixed capital and Working capital. Fixed capital is capital invested in fixed assets, whereas working capital is the capital used for the day to day activities. This is nothing but difference between current assets and current liabilities. The company should not be either under-capitalised company or over-capital-

ised company. If it is under capitalised, high prices of equity shares lead to their limited marketability. Over-capitalisation causes reduction in efficiency.

11.10 Glossary:

1. Capital Stock - Total of the shares value issued to shareholders.
2. Fixed Capital - Investment in fixed assets.
3. Working Capital - Circulating capital.
4. Capitalisation - All long term funds available to the company.

11.11 Self Assessment Questions:

- **Five Marks Questions:**

1. What is Industrial finance?
2. What is meant by under capitalisation?
3. What is working capital?
4. What is over capitalisation?

- **Ten Marks Questions:**

1. Explain importance of Industrial finance?
2. What are the types of Industrial finance?
3. What factors influence working capital?
4. Explain theories Capitalisation?

- **Twenty Marks Questions:**

1. What factors influence fixed capital?
2. What are the reasons for under capitalisation? Explain demerits of under capitalisation?
3. What are the reasons for over capitalisation? Explain its demerits?

11.12 Books Recommended

1. Industrial Organisation and Management
   -R.K.Sharma & K.Gupta.
2. Business Organisation and Management
   -C.B.Gupta.
3. Business Organisation and Management
   -C.B.Gupta.
4. Industrial Organisation and Management
   -A.R.Aryasri.
   -V.V.Ramana Murthy.
5. Principles of Business Organisation and Management
   -Y.K.Bhushan.

- Dr.K.Kanaka Durga

LESSON - 12

SOURCES OF INDUSTRIAL FINANCE

12.0 Objectives:

After studying this lesson you should be able to understand the following aspects

- ➔ Sources of Industrial finance
- ➔ Shares - Types - Merits - Limitations
- ➔ Debentures - Types - Merits - Limitations
- ➔ Public Deposits
- ➔ Other sources of finance
- ➔ Underwriting

Structure

12.1 Introduction:

Finance forms the base for any business. A company needs funds for various types of requirements. Some funds are required for long periods for the purpose of acquiring fixed assets, and some more are required in order to carry on day-to-day transactions. There are other funds known as medium term funds which are required for a period of three to five years as, for example, for a heavy advertisement campaign or for carrying out a complete overhaul of machinery. The method of raising finance has to be decided with reference to the period for which the funds are required.

12.2 Sources of Finance:

All the financial requirements of a company can also be broadly classified into long-term, medium-term and short-term finance. The method of raising finance is linked with the period for which the funds are required. Long-term capital should be raised in such a manner that the company will have its uninterrupted use for a sufficiently long period. For understanding the various sources through which a company can secure long-term, medium-term and short-term finance are given in the following chart:

CHART - 1

FINANCIAL REQUIREMENTS OF A COMPANY

LONG TERM

1. EQUITY SHARES
2. DEBENTURES
3. LOANS FROM FINANCIAL INSTITUTES
4. PLOUGHING BACK OF PROFITS

MEDIUM TERM

1. PREFERENCE SHARES
2. DEBENTURES
3. PUBLIC DEPOSITS
4. LOANS FROM COMMERCIAL BANKS
5. LOANS FROM INDUSTRIAL

SHORT TERM

1. TRADE CREDIT
2. BANK CREDIT
3. INSTALMENT CREDIT
4. CUSTOMER ADVANCES
5. ACCOUNTS RECEIVABLES FINANCE INSTITUTIONS
6. INDIGENOUS BANKERS

12.3 Long Term Finance:

Long term finance is available for a long period say, three years and above. The long-term sources given below are used to purchase fixed assets such as plant and machinery, land and buildings, furniture and fixtures etc.

12.3.1 Own Capital:

Irrespective of the form of organisation such as sole trader, partnership or a company, the owners of the business have to invest their own finances to start with. Money invested by the owners, partners or promoters is permanent and will stay with the business throughout the life of the business.

12.3.2 Share Capital:

In the case of a company, the capital is raised by issue of shares. This capital is known as share capital. The liability of the shareholder is limited to the extent of his share value. Share is a part of capital. The share capital is two types they are-

1. Preference Share Capital
2. Equity Share Capital

12.4 Preference Shares:

Preference shareholders enjoy two rights over equity shareholders. They are-

a) right to receive fixed rate of dividend.
b) right to return of capital.

The rate of dividend on these shares is fixed. Preference shareholders do not have any voting rights in the annual general body meetings of the company. Preference shares are divided in to five types.

12.4.1 Types of Preference Shares:

1. <u>Cumulative Preference Shares</u>: - In case the profits are inadequate or nil in any year, these shares must be paid as arrears of dividends out of future profits.
2. <u>Non-cumulative Preference Shares</u>: - In case of these shares, arrears of dividend will not accumulate and hence any unpaid dividend in any year will not be paid out of future profits.
3. <u>Participating Preference Shares</u>: - These shareholders have the right to participate in dividends if there is any balance after paying dividend on equity shares at a certain rate.
4. <u>Redeemable Preference Shares</u>: - These shares are repaid at the end of a given period. The period of repayment is stipulated on each share.
5. Non-redeemable Preference Shares: - These shares continue as long as the company continues. They are repaid only when the company is liquidated or closed

down.

12.4.2 Advantages of Preference Shares:

1. Preference shares are prefered by the investors who do not want to take risk regarding capital and yet want an income higher than what can be earned on debentures.

2. The management can retain control over the company by issuing preference shares to outsiders because preference shareholders do not have voting right in the general meetings.

3. These shares can be issued as bonus for the buyers of equity shares and debentures.

4. These shares are also useful to the company if it cannot provide collateral security for borrowing on debentures.

12.4.3 Disadvantages of Preference Shares:

1. The issue of these shares is costlier than debentures.

2. Issue of these shares restricts the flexibility of the company.

3. The existance of preference shares is likely to affect the credit worthiness of the company.

12.5 Equity Shares:

Shares which are not preference shares are known as equity shares or ordinary shares. Dividend on them is paid after the dividend on preference shares has been paid. At the time of winding up of the company equity capital can be paid back only after every other claim including those of preference shareholders has been settled. But if company earns more profits equity shareholders get more dividend than preference shareholders. The rate of dividend on equity shares is not fixed.

12.5.1 Advantages of Equity Shares:

1. As the dividends on equity shares are subject to the availability of sufficient profits at the discretion of management, these shares do not impose any burden on the company's resources.

2. As the equity shares have no charge on the assets of the concern the company can easily raise funds in the future by other methods like issuing of preference shares or debentures.

3. These shares are a very good source for providing long-term finance to the company.

12.5.2 Disadvantages Of Equity Shares:

1. As control of the company is left in the hands of equity shareholders, the affairs of the company can be manipulated by equity shareholders.

2. Excessive issue of equity shares may lead to over-capitalisation.

3. If the company issues only equity shares, it losses the opportunity to issue preference shares and debentures at a rate lower than the dividend on equity shares.

12.6 Deferred Shares:

Only private companies are allowed to issue deferred shares. These shares used to be of small nominal value and they were mostly held by the promoters. As each share gave the holder one vote, these shares enabled the promoters to have control over the company with a very small investment.

12.7 Debentures:

A debenture is an instrument issued under the common seal of a company acknowledging its debt to some person or persons under certain terms and conditions endorsed on the back of the instrument. The terms usually refer to the rate of interest, the mode of payment and the security offered for ensuring these payments.

12.7.1 Types of Debentures:

The different kinds of debentures that can be issued by a company are as follows-

1. Simple or Unsecured Debentures: - These debentures are also known as naked debentures. These are issued with merely a promise to pay the holders interest and also to repay principal without any charge or security on any assets of the company.

2. Secured or Mortgage Debentures: - These debentures are issued with a charge on the company's assets as security.

3. Redeemable Debentures: - In case of these debentures, the company reserves the right of paying off the principal on or after a specified date.

4. Irredeemable Debentures or Perpetual Debentures: - In case of these debentures, the company reserves the right of not paying off the principal as long as the company is a going concern and does not make default in the payment of interest.

5. Preferred or First Debentures: - In case of winding up of the company, these debentures are paid first.

6. Ordinary Debentures: - These are also called second debentures. These debentures are paid after the preferred or first debentures have been redeemed.

7. Registered Debentures: - In the case of Registered debentures, the names of the debentureholders are entered in the books of company.

8. Bearer Debentures: - The name of the holders of bearer debentures are not registered in the books of the company, while transferring them there is no need for preparing transfer deed, they can be transferred by mere delivery.

12.7.2 Advantages of Debentures:

Following are the advantages of debentures issue.

1. Debentures offer a definite security.
2. Debentures are entitled to interest irrespective of the company's profit.
3. Debentures are very well suited for cautious investors.
4. The company is enabled to secure additional finance through debentures.
5. Debentures are issued for a fairly long period, the company is assured of finance for that specific period and it can adjust its financial plan accordingly.
6. Debentures carry a fixed rate of interest which is lower than the rate of dividend paid on shares.

12.7.3 Limitations:

As against the merits noted above, debentures possess certain limitations. They cannot be issued by the companies suffering from the following weaknesses:-

1. Companies with fluctuating earnings.

2. Companies with insufficient security to offer.

3. Companies which cannot earn a rate of profit greater than the rate of interest payable on debentures.

4. Companies which are engaged in manufacturing and supplying goods which have high elasticity of demand.

12.8 Differences Between Equity Shares, Preference Shares and Debentures:

TABLE - 1

S.No.	FACTORS	EQUITY SHARES	PREFERENCE SHARES	DEBENTURES
1	Period of finance	Long term finance	Long and Medium term finance	Long and Medium term finance
2	Control of Management	Control vests in equity shareholders	Limited participation in control	No part in Management
3	Return	Rate of Dividend depends on profits	Fixed Rate of profit	Fixed Rate of interest
4	Appeal to investors	Appeal to the adventurous investors	Appeal to relatively less adventurous investors	Appeal to the cautious investors
5	Credit worthiness	Increased capacity to borrow	Does not affect much either way	Reduced capacity to borrow further sums
6	Flexibility	No reduction possible except through re-organisation	can be reduced	can be redeemed
7	Voting Right	They have voting Right	The have voting right under exceptional circumstances	They have no voting right
8	Period of finance	They provide long term finance	They provide both long term and short term finance	They provide both long term and short term finance

12.9 Loans from Financial Institutions/Term Loans:

Term loans constitute another source of long term finance. These are generally repayable in more than one year and less than 10 years. Term loans are borrowed to acquire fixed assets. These are secured loans, payment of interest on a term loan is a statutory obligation. The prominant institutions providing long term debt in our country are UTI, IDBI, IFCI, ICICI, NSIC, Insurance companies SFC's SIDBI etc.

- **Advantages:**

By borrowing from these financial institutions, the companies enjoy certain advantages. They are-

1. Timely assistance
2. Flexibility
3. Economy in case of interest
4. Non-interference with management

12.10 Ploughing Back of Profit/Retained Earnings:

The Retained profits are the profits remaining after all the claims. They form a very significant source of finance. Retained earnings can be advantageously utilised, particularly in times of growth and expansion. It is also known as 'internal financing' or 'self financing'.

12.10.1 Advantages of Ploughing Back:

Following are the important advantages of ploughing back of profits.

1. The policy of ploughing back helps the company to build up reserves which can be used for the purpose of expansion and improvement of business.

2. To escape the crushing effects of depreciation.

3. It is economical method of financing.

4. Reserves created by the ploughing back of profits can also be used for redeeming debts and for replacing.

5. Ploughing back is extremely important for speedy capital formation.

12.10.2 Dangers of Excessive Ploughing Back:

1. By continous ploughing back of profits over a long period of time, a company may grow into a monopoly.

2. The management may not always use the retained profits to the advantage of the shareholders.

3. If the accumulated reserves are used for the issue of bonus shares, it may result in over-capitalisation later on.

4. An over-enthusiastic policy of ploughing back the profits may create dissatisfaction among the shareholders

5. It may give the management an opportunity to manipulate the share values.

6. By withholding profits, lower dividends may be declared.

12.11 Medium Term Financial Sources:

Medium term finance refers to those sources of finance where repayment is normally made between one and three years. This finance is utilised to buy or lease motor vehicles, computer equipment, or machinery, the life of which is less than three years. Following are the main sources of medium term finance.

- **Preference Shares:**

Preference shares are also one of the sources of medium term finance of industrial sector. Preference shares carry a preference both regarding dividend and the return of capital. The rate of dividend on a preference share is fixed. The redeemable preference shares constitute a good source of medium funds required by companies. A company can convert its accumulated profits into such shares and can redeem them as and when over capitalisation arises. Besides, the issuing company can redeem shares carrying high rates of dividend when the rates in the money market are favourably low.

12.11.1 Debentures:

A debenture is an acknowledgement under seal, of debt or loss. Redeemable debentures are one of the sources of the medium term finance. These will be repaid by the company at the end of a specified period or by instalments during the existence of the company.

12.11.2 Public Deposits:

Public Deposits are the chief and even the only, source of working capital for the industry. This system became popular because of the imperfect development of banking system in the country. The companies can invite or accept deposits only after complying with the legal requirements.

- **Merits:**

1. Inexpensive: - As the interest on public deposits is usually low, this method of raising working capital is cheap and inexpensive.
2. Simple: - Raising of working capital through this method is very simple and does not involve any formalities.
3. Higher dividends: - Lower interest payments on deposits enable companies to declare higher dividends.

4. No security requirement: - A public deposits are mostly unsecured debts, the assets of company remain unencumbered.

5. Economical: - The borrowing concerns need not pay interest on deposits when the deposits are not in use.

- **Demerits:**

1. Unreliable: - The system is unreliable, because during the periods of depression when the industry needs more money, the depositors withdraw their funds out of panic, resulting in the closing down of the unit.

2. Unhealthy for capital market: - The dependence on public deposits reduces the number of good industrial securities in the investment market.

3. Uneconomical: - As there are better avenues of investment available to investors, generally the investors demand higher rates of interest on their deposits with the companies.

4. Difficulty in collection: - Due to the following reasons, public may not come forward to deposit the amounts with companies.

   a) Rate of return is meagre
   b) Possibility of speculation
   c) Lack of proper security

12.11.3 Loans from Commercial Banks:

The funds of the joint stock banks in India are mainly the accumulated deposits of the public and are withdrawable at short notice. In view of this, the Indian banks do not want to tie up their funds in long-term loans and they are making advances mainly for medium term and short term.

12.11.4 Loans from Industrial Finance Institutions:

Assistance from these institutions has become an important method of financing the medium term requirements of new companies as well as the going concerns. The assistance of these institutions may take the form of direct subscription to company securities, underwriting of new security issues, grant of loans, gauranteeing of loans and debentures, and guaranteeing of deffered payments against imports of capital goods etc. The main industrial finance institutions are Industrial Finance Corporation (IFC), IDBI, SFC and ICICI some of these institutes, particularly the ICICI, provide technical know-how and all of them make available to the eligible companies expert advice on the planning and execution of projects.

12.12 Short Term Financing:

Apart from the varoius sources of finance there are also other short-term credit facilities to the business firms through trade credit, bank credit, accounts receivable financing, instalment credit and customer advance.

12.12.1 Trade Credit:

Trade credit is granted by the seller to the firm which purchases the goods. For granting this type of credit no security is required and generally it is granted on the basis of the financial standing and goodwill of the purchaser. Trade credit is usually granted for a period ranging from 30 to 90 days. Availability of trade credit from the supplier depends on his financial resources, his eagerness to dispose of his stock, nature of competition, credit-worthiness of the firm and money market conditions.

12.12.2 Bank Credit:

This type of credit is useful to the companies for the day-to-day working of the company. The bank credit may take the form of overdraft, cash credit, advance and discounting of bills.

12.12.3 Instalment Credit:

Under instalment credit firms get the facility of buying equipment on easy instalments. Thus through this facility firm receives the financial assistance in kind.

12.12.4 Accounts Receivable Financing:

The business firms have taken resort to the method due to the increase in the demand for additional working capital. Under this method the business firms enter into an agreement with the financing institutions according to which the financing institutions agree to purchase the accounts receivable of the business firm or to advance funds on the security of such receivables. The rate of interest charged by the financing institution depends on

1. the percentage of the face value of accounts receivable advanced.

2. the prevailing rate of interest.

If there are any bad debts due to the default of the buyers, the financing institution is not responsible and the seller has to bear such losses.

12.12.5 Customer Advances:

Sometimes, companies receive part of the short-term finance from the customer by way of advance. The customer advance depends on the conditions of the market and the custom of the trade. Generally customer advance carries no interest and it represents part of the price of the commodity that will be purchased by the customer at a later date.

12.12.6 Indigenous Bankers:

Indigenous Bankers like Marwadies, Sharabs also provide short term finance. But they charge high rate of interest.

12.12.7 Commercial Paper:

It is a new instrument in the money market introduced in India. Commercial papers are usually issued in large denominations by leading, nationally reputed, highly rated and credit worthly large manufacturing and finance companies in the public and private sector. Reliance industries is one of the early companies which introduced commercial paper.

12.12.8 Bank Overdraft:

This is a special arrangement with the banker where-by a customer can draw more money than there is in his account upto a maximum limit. Interest is charged on a day-to-day basis on the amount overdrawn. This source is utilised to meet the temporary shortage of funds.

12.12.9 Internal Funds:

Internal funds are generated by the firm itself by way of secret reserves, depreciation provisions, Taxation provisions etc. These can be utilised to meet the urgencies.

12.13 Underwriting:

The activity of ensuring the sale of shares or debentures of a company, even before offering to the public, is called underwriting. The members who are engaged in such activities are called underwriters. If some securities remain unsold, the underwriters will have to buy them. For this service, they charge commission which cannot exceed 5 per cent of the issued price of the shares and 2 per cent of the issued price of debentures.

12.13.1 Merits of Underwriting:

The advantages of underwriting are as follows-

1. Guarantee: - Underwriters render valuable services in the promotion of companies by Gauranteeing the promoter against the sale of the shares and uncertainty and risk.

2. No waiting for the sale of securities: - As the promoter gets from the underwriters a large sum of cash at once, irrespective of the sale of securities, the company is enabled to proceed with its projects without waiting for the actual sale of securities.

3. Escapes the danger of undercapitalisation: - The company gets assurance from the underwriters for subscribing the entire capital within a definite period and this escapes the danger of undercapitalisation.

4. Specialised skills: - underwriters possess specialised experience and skill and many times they provide expert advice to the companies regarding the form or price of the new securities.

5. Financial integrity: - Underwriters are very often men of financial integrity and established reputation, the association of whose names with an issue often raises the issue high in public estimation.

6. Geographical dispersion: - As underwriters maintain working arrangement with the brokers in other areas, geographical dispersion of security is facilitated.

7. Guarantee for the soundness of securities: - Prospective buyers are also benefited by the underwriters. The fact that the securities of a particular concern are underwritten by a reputed firm acts as a gaurantee for the soundness of securities.

12.13.2 Demerits:

Inspite of the several advantages of underwriting, it has not well developed in India, due to some obstacles.

1. India's industrial development began rather late and hence capital market remained undeveloped for a long time.
2. Lack of specialised financial institutions like the investment banks of the U.S.A.
3. The commercial banks in India followed the policy of staying away from industrial banking and underwriting.
4. The managing agents performed the underwriting function and this naturally prevented the development of underwriting institutions.

Since 1955 some progress in the direction of underwriting has been made. Now the function of underwriting is done by private firms, commercial banks, the UTI and also by industrial and development corporations such as ICICI, IFC, IDBI, LIC.

12.14 Summary

Finance can be long term, medium term and short term. Long-term finances are repayable over a period of more than three years. Medium term between one and three years and short-term finance must be paid within one year. Sources of long-term finance include own capital, equity and preference share capital, retained earnings, long-term loans, debentures, etc. Preference shareholders enjoy right to dividend and right to return of capital. Preference shares are in five categories. Equity shareholders get dividend depending on the profits of the company. debentures are loan Documents and they cary a fixed rate of interest. Sources of medium term finance include bank loans, hire-purchase etc. Sources of short term finance are commercial paper, bank overdraft, trade credit, debt etc. Institutions providing long-term finance include investment trusts, UTI, Insurance Companies, IFC SFC ICICI IDBI SIDBI, SIDC etc. Private Banks provide finance for short term purposes.

12.15 Glossary

Share: Part of Capital.
Debenture: Loan Document.
Public Deposit: Collection of deposit from public.
Cash Credit: Credit granted by cash.
Underwriting.
Trade Credit.

12.16 Self Assessment Questions:

- **Five Marks Questions:**

1. What is equity share?
2. What is Debenture?
3. What is meant by Public Deposits?
4. Explain Underwriting?

- **Ten Marks Questions:**

1. Explain features of preference shares?
2. What are the advantages of equity shares?
3. What are deferred shares?
4. Explain limitations of public deposits?

- **Twenty Marks Questions:**

1. What is share? Explain varoius types of shares?
2. What is Debenture? Explain varoius types of Debentures?
3. Distinguish shares from Debentures?
4. Describe Short term sources of industrial finance?
5. What are the advantages of Underwriting?

12.17 Books Recommended:

1. Industrial Organisation & Management.
   -C.H.Shanmukha Swami

2. Industrial Organisation & Management.
   -R.K.Sharma & K.Guptha

3. Industrial Organisation & Management.
   - A.R.Aryasri & V.V.Ramana Murthy

4. Fundamentals of Business Organisation & Management.
   -Y.K.Bhushan.

- Dr.K.Kanaka Durga.

LESSON - 13

STOCK EXCHANGES

13.0 Objectives:

After studying this lesson you should be able to understand about-

1. Stock exchanges - Meaning, Functions, Importance Procedure of Trading etc.

2. Speculation - Types of speculators, Operations of speculators.

Structure

13.1 Introduction:

The term securities market is a comprehensive one and refers to the buyers and sellers of securities. The structure comprising all those agencies and institutions which help in the sale and re-sale of company securities. It includes and encompasses the following activities-

1. Activities in originating, distributing and trading in securities.
2. Organisations which facilitate to activities in the securities market.

3. Persons and organisations who buy and sell securities.

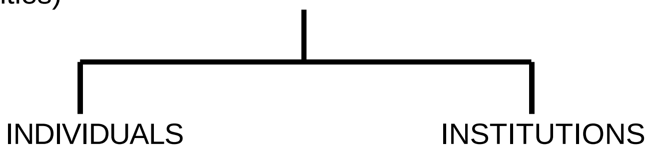
4. Regulations which influence and control the organisation in the securities market.

The stock Exchange is concerned with the re-sale of securities. It is the market where stocks or securities are exchanged for investment or speculative purposes.

13.2 Stock Exchanges

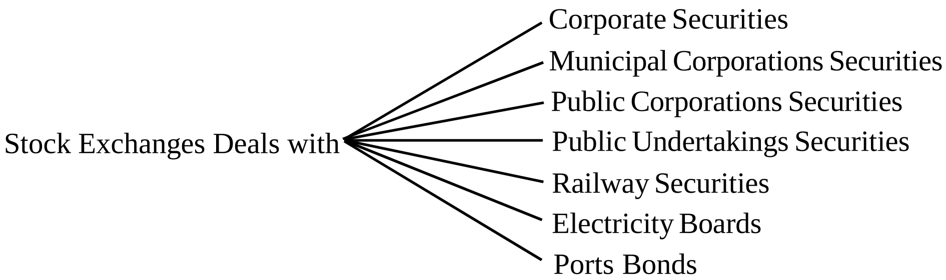
A Stock Exchange is a physical place where already issued corporate securities such as shares, debentures and Government bonds are traded. Hence it is the secondry market. It is an organised market which facilitates the buying and selling of corporate securities which have already been issued by companies. Structure of Stock Exchange is as follows-

FIGURE - 1
STOCK EXCHANGE
(Trading in listed securities)



The securities that are traded on a stock exchange normally include apart from corporate securities and bonds issued by local bodies such as municipal corporations, public corporations, public utility undertakings such as railways or state electricity boards, ports etc.

FIGURE - 2



13.2.1 Meaning Definition:

Section 2 of the securities contract (Regulation) Act, 1956 defines stock exchange as "any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing securities".

In other words, a stock exchange is an association, organisation or body of individuals established for the purpose of facilitating and regulating trading operations in corporate securities. It is an organised market for the purchase and sale of second-hand listed industrial and financial securities. It is the place where one who wants to buy a particular security may find an immediate seller, and one who wants to sell his holdings may find a buyer at a reasonable and fair price.

13.2.2 Significance and Economic Functions:

The significance of a stock exchange lies in the various functions it performs. A vibrant stock exchange is a prerequisite for inculcating financial discipline in the corporate world. The more active and transparent the stock exchanges are, the more the investor confidence. Consequently, capital formation will go up that result in greater economic development of the nation. It performs certain essential economic functions but for which companies controlling the industrial world would find it difficult to finance their schemes. The functions of stock exchange can be explained in detail as given below.

1. <u>Ready Market</u>: - The stock exchange is essentially a market for existing securities. This market is continuously available for the conversion of securities into cash and cash into securities. This means increased liquidity and better marketability for securities. The investor will naturally find it more convenient to invest his savings in shares which are more liquid than in any other type of investments. This motivates both individual and corporate investors to invest their surplus funds in securities. Loans can be raised against these listed securities.

2. <u>Evaluation of Securities</u>: - A share acquires liquidity because of being traded on the stock exchange. The stock exchanges insist that the prices at which bargains are made shall be recorded and made available to public. These prices become market quotations on the fiath of these quotations every investor knows the worth of his holdings at any one time.

3. <u>Safeguards for Investors</u>: - The stock exchanges protect the interests of investors through the strict enforcement of their rules and regulations. A broker who deals with exchange of securities may charge an excessive rate of commission for his services if he is not working strictly under the rules of a stock exchange.

4. <u>Regulation of Company Management</u>: - A company which wants its securities to be quoted and traded on a stock exchange has to get it enrolled on the official trading list of the particular exchange. For this it has to submit to the rules framed by the stock exchange in this regard. Through these rules and requirements, stock exchanges exercise wholesome influence on the management.

5. <u>Proper Canalisation of Capital</u>: - When the securities of a company are being sold above par for a long time, it indicates good prospects for the enterprise. The public will naturally be attracted by such prospects. Thus, the savings of individuals begin to be attracted towards such a company and it can easily raise fresh additional capital.

6. <u>Agency of Capital Formation</u>: - A stock exchange creates the habit of ‘saving’, investing and risk-taking among the members of the general public. This habit leads to investment of funds in corporate Government securities. The dividend or interest on such investments is also usually invested back in industrial enterprises or Government projects.

7. <u>Facilities for Speculation</u>: - Due to speculation, the supply of securities at different places may be equalised with demand. If a share is selling at a higher price in one

market, the speculators will buy it from other markets, and sell it there till the supply these matches the demand. Similarly the price movements are made smoother by the activities of speculators.

8. Barometer of Economic and Industrial Progress: - One of the indicators of the economic progress of a country is the presence of a well-organised, transparent and regulated stock exchange. Stock exchange operations are indicative of the prosperity of a particular economy.

9. Provide Credibility: - Stock exchanges provide credibility about the companies to the investors and other companies. Such companies enjoy a high degree of reputation, credit worthiness. It will be very easy for such companies to raise funds to meet their additional capital requirements.

Due to the important economic functions performed by the stock exchanges, they have earned a variety of names such as 'the mart of the world', market where business of businesses is carried on'. According to Marshall "stock exchages are not merely chief theatres of business transactions, they are also barometers which indicate the general condition of the atmosphere of business.

Even a slight change in the economic policy of the Government would be reflected in the dealings of the stock exchange.

13.2.3 Utility :

The economic utility of stoch exchanges may be examined from three angles:

From the point of view of community-

a) The stock exchange provides a group of interested investors.

b) The stock exchanges assists the enterprises in raising further funds.

c) The Government, can undertake projects by raising funds through stock exchanges.

From the point of view of the company-

a) A company whose shares are quoted on the stock exchanges generally enjoys better reputation and credit.

b) The Market for shares which are listed with stock exchanges have great reputation.

c) The listing of securities with stock exchanges raises the bargaining power of the company in the time of merger or amalgamation.

From the point of view of an investor-

a) The liquidity of the investment is increased.

b) The listed securities enjoy a good collateral security for loans.

c) The stock exchange safeguards his interest through strict enforcement of rules and regulations.

13.3 Speculative Activities in Stock Exchanges:

The stock exchange is an institution of rather recent growth. The first stock exchange was set up in India under the name and style of the Native share and stock Brokers' Association of Bombay, known as the Bombay stock exchange in 1887. The general affairs of a stock exchange are administered by a Committee of Management.

13.3.1 Meaning:

speculation refers to activities carried out in the hope of making windfall profits by substantial fluctuations in the market prices of securities over a period of time. Those who keep buying and selling these securities are called speculators. Speculators are interested in quick profits.

13.3.2 Types of Speculators:

The speculators on a stock market are given different names depending upon the nature of their speculative activity. Each type is named after a beast, probably on the basis of its resemblance with the behaviour of the animal. Bulls, bears, stags and lame ducks are found active in stock exchanges.

1. <u>Bull</u>: - A bull is a speculator on the stock exchange who expects a rise in the price of a certain security. With this expectation, he buys up the security to sell it in future at the expected higher price to reap profit. A bull is also known as a tejiwala. He is an optimist. Such a speculator is called a bull because of the tendency of the bull to throw his victim up in the air. If the price falls instead of rising, the bull speculator incurs a loss. Thus, a bull is almost a gambler and his pressure automatically raises the price.

2. <u>Bear</u>: - A bear is also known as mandiwala, he is a speculator who expects a fall in the price of the shares of a company. With a view to taking advantage of an expected fall in the price of the shares of a company. With a view to taking advantage of an expected fall in the price, he agrees to sell for delivery on a fixed date such securities as he may or may not possess. When the date of delivery comes, he purchases securities at a lower price and fulfils his promise at a higher price. In this way, he makes profit from a fall in the price of a security. If however, the price of the security rises. In such a case, he will suffer a loss.

3. <u>Lame Duck</u>: - When a bear finds it difficult to meet his commitments immediately he is said to be struggling like a lame duck.

4. <u>Stag</u>: - As compared with the bulls and bears on the stock market, a stag is comparatively much more cautious in his dealings. A stag neither buys nor sells securities, but merely applies for shares of a new company as if he were a genuine investor. The shares applied for may begin to be sold at a premium i.e, above the par value when, therefore, a stag receives the allotment of these shares, he at once sells the allotment at a premium. His profit is equal to the difference between the price paid by him and the price at which he sells his allotment.

13.3.3 Speculative Operations:

Speculative activity is carried on through the following types of specialised transactions:

1. Option Dealings: - An option in the stock exchange terminology means a right. In an option deal, therefore , the right to buy or sell a certain security within a certain time and at a certain price is purchased from a dealer. Right to purchase securities is known as call option. If it is right to sell securities is known as call option. If it is right to sell the securities it is known as put option. When the two options are combined, it may be referred to as a double option or a put and call option. When a speculator expects the price of a security to rise in future, he may obtain or purchase a call option. Similarly, a put option is usually secured by those who expect a fall in the share prices.

2. Hedging: - The options can be used for the purposes of hedging also. Hedging refers to any device through which one can protect oneself against loss. If a bull speculator agrees to purchase the security from somebody, he may hedge himself by buying a put option so that any loss that he may suffer in his original transaction may be offset by the exercise of the put option. Similarly, an intending seller can hedge himself against loss through a call option.

3. Margin Trading: - Most of the speculative purchases are made on the basis of margin trading. It means that the shares are purchased by the clients with funds borrowed from the brokers. For margin trading, the client opens an account with the broker. He makes a deposit of cash or securities in this account, and agrees to maintain the margin at a certain level. When the broker purchases securities on his behalf his account is debited with the amount of such securities.

4. Margin System: - The term margin is also applied to the deposit which the members are required to maintain with the clearing house of the stock exchange. This deposit is a certain percentage of the price of the securities which is traded by members.

5. Arbitrage: - Arbitrage is a highly specialised and skilled speculative activity which is undertaken to make profit out of differences in prices of a security in two markets. If the price of a certain share is higher in one market than in another, the speculator will find it profitable to purchase such shares in the cheaper market with a view to selling them at a profit in the other market. Arbitrage may be described as ‘traffic in securities’. Such traffic may be carried on between two markets within the country or in two different countries.

6. Wash sales: - A wash sale is a kind of fictitious transaction in which a speculator sells a security and then buys it at a higher price through another broker, in this way, a false and misleading opinion about the price of the security is created in the market. As a result of such opinion, the price records a further rise and the broker-speculator is able to reap profits by unloading his holdings to the public.

7. Cornering: - A corner is the condition of the market in which almost the entire supply of a particular security is held by an individual or group of individuals. In such an event, the bears who have contracted to sell the security without actually possessing it, would be

unable to deliver it to the buyers who have cornered the market. The buyers will, therefore, be in a position to dictate terms to the short-sellers. In technical jargon, short-sellers are 'squeezed'. This is also an undesirable activity.

8. Rigging the Market: - Rigging the market means artificial forcing up of the market value of a particular stock. It is the result of a bull movement where by the demands of the buyers force up the price.

9. Blank Transfers: - Blank transfer facilitate speculation in securities. The transferor merely signs the transfer form and does not fill in the name of the transferee while transfering shares, it is known as a blank transfer. Such a transfer is particularly useful and convenient when the shares are to be transferred as a part of a carry-over. This transfer encourages unhealthy speculation.

13.3.4 Differences Between Investor and Speculator

TABLE - 1

S.No.		INVESTORS	SPECULATORS
1.	INVESTMENT	Investors are genuine, they purchase securities with a view to investing their money for the purpose of getting an income.	Speculators buy with a hope to sell in future at a profit.
2.	INTEREST	They are interested in reasonble return on their investment.	They are interested in high profits.
3.	SAFETY	They care more for safety.	They want quick profits.
4.	DELIVERY OF SECURITIES	He takes delivery of securities after purchase.	He does not take delivery of the securities, he only receives or pays the difference between the purchase and sale price.

13.4 Listing of Securities:

Listing of securities means the inclusion of the securities in the official list of a stock exchange for the purpose of trading. The securities of a company can be listed only when it furnishes the necessary details about its organisation and working to the stock exchange and fulfils the conditions laid down in the rules and regulations. But this should not be taken to mean that the stock exchange guarentees the financial soundness of the company, or recommends the securities for favourable consideration. The stock exchange indicate following things at the time of listing-

1. the company is legally organised and
2. the company is legally solvent as a going concern.

Listing naturally creates a favourable impression on the mind of the prospective investor.

■ **Advantages:**

Following are the advantages to the company if they list their securities with stock exchange.

a) The company is legally organised.

b) Listing enhances its credit.

c) Listing widens the market for its securities.

d) Raises the value of its securities.

Investor gets the following advantages-

a) Listing ensures safety of dealing.

b) Convenient for quick disposal of securities in time of need.

The securities contracts (Regulation) Act 1956 gives the Central Government the power to compel an incorporated company to get its securities listed with a recognised stock exchange in accordance. With the rules and regulations prescribed for the purpose. If a recognised exchange refuses to list the securities of a company, the company can file an appeal against such a decision with the Government.

13.4.1 Statutory Rules for Listing of Securities:

The Government has framed the following statutory rules for the listing of securities under the securities contracts (Regulations) Act.

1. A company requires a quotation for its shares, must apply in the prescribed form supported by the documentary evidence mentioned below.

a) copies of Memorandum and Articles of Association, Prospectus, Directors' Reports, Balance Sheets and agreements with underwriters etc.

b) specimen copies of shares and debenture certificates.

c) particulars regarding its capital structure.

d) A statement sharing the distribution of shares.

e) particulars of dividends and cash bonuses during the last ten years.

A brief history of the company's activities since its incorporation.

(i) <u>Criteria for listing</u>: - The stock exchange will pay special attention to the following particulars while scrutinising the application:

a) Whether articles contain the following provisions.

1. A common form of transfer shall be used.

2. Fully-paid shares will be free from lien.

3. calls paid in advance may carry interest, but shall not confer a right to dividend.

4. Unclaimed dividends shall not be forfeited before the claim becomes time barred.

5. Option to call of shares shall be given only after sanction by the general meeting.

b) Whether at least 49% of each class of securities issued was offered to the public for subscription through news papers for not less than three days.

c) Whether the company is of a fair size, has a broad based capital structure and there is a sufficient public interest in its securities.

After scrutiny of the application, the stock exchange authorities may, if they are satisfied, call upon the company to execute a listing agreement which contains the obligations and restrictions which listing will entail.

13.5 Procedure for Dealing at Securities Or Method Of Trading:

i) <u>Choice of a Broker</u>: - It has been observed earlier too, that a non-member is not allowed to enter the hall of the exchange and transact business on his own behalf. If an outsider has some savings with which he would like to deal on the stock exchange, he will have to depend upon a broker-member of the exchange. He can also act through his bank which may have its own brokers.

ii) <u>Engaging a Broker</u>: - After selecting a broker, the next step would be to ask him if he would be willing to transact business on behalf of the party concerned. The broker would usually ask for a formal introduction of the party or a reference from the banker.

iii) <u>Placing the Order</u>: - Now the investor has to select the securities in which he would like to invest his money. The client will, then, place an order with the broker. The order is placed by wire or on the telephone to avoid delay. For instance the order for the purchase of 100 ordinary shares of the Delhi Cloth Mills at Rs. 36 may be placed as “Buy 100 DCM at Rs. 360” or at best or at the market order.

- when the client instructs the broker to buy or sell certain shares at a fixed price mentioned in the order. It is called a fixed price or at limit order. It may be worded thus Buy(or sell) 100 centuries at 725.

- An immediate or cancel order is that which must be executed at once at the best possible price. It would be ordered as “Buy or sell 100 Tatas order at 215.

- A stop-loss order is placed by the client with a view to protecting himself against a heavy fall or rise in prices. It may be placed as "Buy 100 DCM at Rs. 300 stop". This means that the broker must not purchase the shares so long as the price remains below Rs. 370. As soon as it reaches Rs. 370 and begins to rise, the broker must execute the order at best price obtainable.

- When the client has full faith in the broker, he may instruct him to buy or sell shares at whatever price he thinks reasonable. It may be called a 'discretionary order'.

- When the client places a limit it is referred to as an 'open order'.

iv) Making the Contract: - The authorised clerk goes to the pit and makes his own quotation for the purchase or sale according to the conditions of the market. In case the clerk is not satisfied with the quotation given to him, he may go to some other dealer.

v) Preparation of Contract Note: - The broker prepares a contract note in the prescribed form and signs it himself. The note contains the details of the contract made for the purchase or sale of securities and includes the amount of brokerage due to the broker. A copy of the contract note is sent to the client.

vi) Settlement: - Now the procedure to purchase or sell the securities comes to an end. On the basis of the nature of transactions in stock exchange, we can classify all transactions into-

1. Ready delivery contracts and

2. Forward delivery contracts.

1. Ready delivery contracts: - Ready delivery contracts involve the actual payment of the price by the buyer in cash and delivery of securities by the seller. These contracts are settled either on the same day or within a short period of time, usually not exceeding one week. The settlement of ready delivery contracts depends also on the type of securities dealt in. If the securities are cleared securities, they are settled through the clearing house. If they are non cleared securities, they are settled between the members by hand delivery and without the intervention of the clearing house.

2. Forward delivery contracts: - Under these contracts, settlement is made on the spot, but an agreement is made to settle the transactions at a particular date. Fixed settlement days occur either at fortnightly or monthly intervals. When the settlement day arrives, if both the parties agree, the settlement of transactions can be postponed to next settlement day. When it is carried over to next settlement day, it is called budla.

vii) Clearing House: - With the object of facilitating transactions of members among themselves, stock exchanges maintain clearing houses. The functions of clearing house is to act as the agency for the clearance of contracts both in regard to securities and payment of their price. The clearing house helps the members to give or receive only net dues and this saves the members from the botheration of making and receiving total amounts of their transactions.

Difference Between Jobber and Broker

TABLE - 2

S.No.		JOBBER	BROKER
1.	NATURE	Specialist	Generalist
2.	OBJECTIVE	Works for profit	Works for commission
3.	CLIENTS	Broker or another jobber	Non-members
4.	EARNINGS	Profit	Commission
5.	SPECIALISATION	Specialises in few securities	No specialisation
6.	BUSINESS	Business is transacted directly with brokers and other jobbers	By connecting investing public and jobber
7.	PROTECTION	No such obligation	He protect the interest of the investors

13.6 Regulation of Stock Exchanges in India:

The activities of stock exchanges are regulated under the provisions of the securities contracts Regulation Act. The provisions are as follows-

1. Recognition of a stock exchange: - The Central Government grants recognition after it is fully satisfied that the following conditions have been fulfilled.

a) Rules and regulations of the applicant exchange should be fair.

b) The applicant exchange undertakes to abide by all the conditions of the Government from time to time.

c) Recognition of stock exchanges is essential.

2. Controlled by the Central Government: - The Central Government, is the controller which can direct the exchange to-

a) Submit its annual reports.

b) It also can order an equity into the affairs of the stock exchange.

c) force public limited companies to comply with the listing procedures to get their shares listed.

d) Prohibit dealings in notified securities.

e) Pay penalty for every type of undesirable practices of speculation.

3. Powers: - The Government is empowered, under the act, to regulate the following issues relating to the operations of a stock exchange.

a) Trading hours of a stock exchange.

b) Regulation in respect of bank transfers and carry over facilities.

c) Maintainance of a clearing house.

d) Regulation of business dealings of tarawaniwalas.

The Securities and Exchange Board of India (SEBI) Act, 1992 made SEBI the apex body to regulate capital markets and vested it with statutry powers. Since then, the SEBI has been initiating a series of reforms to improve investors protection through automation of trading operations, integration of national stock markets etc. and thus enhancing the overall efficiency of market operations. The securities contracts (Regulation) Act was amended in 1996. The powers hither to exercised by the Central Government under this act are now vested with the SEBI.

13.7 Directorate of Stock Exchange:

The Government of India set up the Directorate of stock exchange in 1959. The object of this directorate is enforcing and administering the regulatory provisions of the securities contracts (Regulation) Act. It maintains a close watch on the activities of stock market. It is also concerned with the control of kerb trading and prevention of option dealings. The task of granting licences to individual dealers in securities in areas outside the recognised exchanges has also been entrusted to the directorate. Thus it is the agency of Government.

13.8 Summary:

Stock Exchanges provide liquidity and the current market price of corporate securities. Section 2(1) of the securities contract (Regulation) Act 1956, defines a stock exchange as ‘any body of individuals, whether incorporated or not, constitute for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities. The significance and functions of a stock exchange are evident from the following:

→ provides liquidity, mobilises savings, reflects the economy, enables trading at fair prices etc.

→ Speculation refers to activities carried out in the hope of making windfall profits by fluctuations in the market prices of securities over a period of time.

13.9 Glossary:

1. Making a Market: - When demand for a particular security is created for particular class of shares. The process is known as making a market.

Jobber: - Independent dealer in securities.

Broker: - Commission agent.

Authorised Clerk: - Clerks authorised to transact business on behalf of their member employers.

Speculation: - Acitivity carried out in the hope of making windfall profit.

Margin: - Balance with broker.

13.10 Self Assessment Questions:

- **Five Marks Questions:**

1. What is meant by Stock Exchange?
2. What is Speculation?
3. Explain Option Dealing?
4. Explain Directorate of Stock Exchanges?

- **Ten Marks Questions:**

1. Explain the functions of Stock Exchange?
2. Differentiate Investor from Speculator?
3. What are the differences between Jobber and Broker?
4. What are advantages of Stock Exchanges?
5. How the securities are listed with Stock Exchange?

- **Twenty Marks Questions:**

1. 'Stock Exchanges economic barometers' - Explain?
2. Describe the Types of Speculators?
3. Describe Speculative Operations?
4. What is the procedure of Trading in Stock Exchanges?
5. How the Stock Exchanges are regulated in India?

13.11 Books Recommended:

1. Fundamentals of Business Organisation and Management.
-Y.K.Bhushan.

2. Principles of Business Organisation and Management.
-P.N.Reddy.
-S.S.Gulshan.

3. Industrial Organisation And Management.
-A.R.ARyasri.
-V.V.Ramana Murthy.

- Dr.K.Kanaka Durga

LESSON – 14

MUTUAL FUNDS – SEBI

14.0 Objectives:

After studying this lesson you should be able to understand the following

- What are Mutual Funds – Meaning – Merits – Types
- Management of Mutual Funds
- Establishment of SEBI – Its Functions
- Role of SEBI in Capital Market

Structure

14.1 Introduction:

The mutual fund is formed and registered as a trust under the Indian Trust Act. The trustees of the Mutual Fund hold its property for the benefit of unit holders. An Asset Management Company (AMC) must be approved by Securities and Exchange Board of India to manage the Funds of the Trust. Mutual Fund is one of the several investment options for the investors. Risk is the inherent feature of every investment plan. The Mutual Fund market which started with an asset base of Rs. 0.25 billion is 1964 grew at a compounded average growth rate of 26.34 percent to Rs. 1130 billion in 2001.

14.2 Mutual Funds - Meaning:

"A Mutual Fund is a trust that pools together by issuing units the savings of a number of individual or corporate investors for the purpose of investing in corporate securities in accordance with the objectives in an offer document".

A trust may be established by one or more sponsors. The trustees appoint the sponsor or Asset Management Company to manage money on their behalf. For example, LIC Mutual Fund is sponsored by LIC of India and the investment manager is Jeevan Bhima Sahayog Asset Management Company (AMC) Limited.

14.2.1 Features:

Following are the important features of Mutual Fund.

1. Formation: - It is formed and registered under the Indian Trust Act.

2. Objective: - Each Mutual Fund has a defined investment objective and strategy.

3. The Rules of the Fund: - At the time of launching the fund, the Mutual Fund Company specifies in advance the investment objectives of the fund, the risk associated with, the cost involved in the process etc.

4. Regulatory Authority Approach: - In India, every Mutual Fund needs an approval from the SEBI. The SEBI approves the fund after looking at the track record of the sponsor and its financial strength.

5. Operational Procedure: - The sponsor hires an Asset Management Company (AMC) and custodian of the assets of the fund to invest and manage the funds according to the specified objective.

6. Investments in Securities: - The fund manager invests the money thus collected in different types of corporate securities such as shares, debentures, bonds etc.

7. Distribution of Earnings: - The income earned through their investments and the capital appreciation realised by the scheme is shared by its unit holders in proportion to the number of units owned by them.

8. Net Asset Value (NAV): - Every Mutual Fund has to disclose the NAV of each of its schemes on a regular basis-daily or weekly-depending upon the type of scheme.

9. Professionalisation: - Every Mutual Fund manages its portfolio professionally. Professionalisations brings forth high returns at as relatively low cost.

10. Permits Moderate Investments: - Anyone with moderate surplus funds as much as even as Rs. 1000 can invest in the fund.

14.2.2 Merits:

Mutual Funds could successfully integrate their products and services with the needs and aspirations of the common investor. Investments in Mutual Funds are perceived to be more attractive than in banks and other traditional revenues. Mutual Fund investment brings many benefits to the common investor. They are:

1. Professional Management: - An experienced and dedicated investment research team of professionals monitors the funds and analyse the performance and prospects of companies. Suitable investments are selected to achieve the objectives of the scheme.

2. Diversification: - Mutual Funds invest their funds in a large number of companies across a broad cross-section of profitable industries and sectors. This diversification reduces risks, as all stocks may not decline at the same time and in the same proportion.

3. Free From Tension: - Investing in a Mutual Fund relieves an investor from a lot of tension resulting from excessive paper work, bad deliveries, delayed payments, thus it saves time and makes investing easy and convenient.

4. Higher Returns: - Over a long term, Mutual Funds can earn enough surplus so as to provide a higher return as they invest in a diversified basket of selected securities.

5. Low Costs of Operation: - It is relatively inexpensive to deal through Mutual Funds when compared to directly investing in the capital markets.

6. Liquidity: - Open-ended schemes provide ready money to the investor at Net Asset Value (NAV). In close-ended schemes, the units can be sold on a stock exchange at the prevailing market price.

7. Transparency: - Regular information is available on the value of investment, specific investments made by a particular scheme, the proportion invested in each class of assets and the fund managers' investment strategy and out look.

8. Flexibility: - One can systematically invest or withdraw funds according to one's needs and convenience. There is a lot of flexibility built into the scheme.

9. Affordability: - With affordable amounts, one can enter a Mutual Fund that will invest there funds in highly graded and profitable stocks.

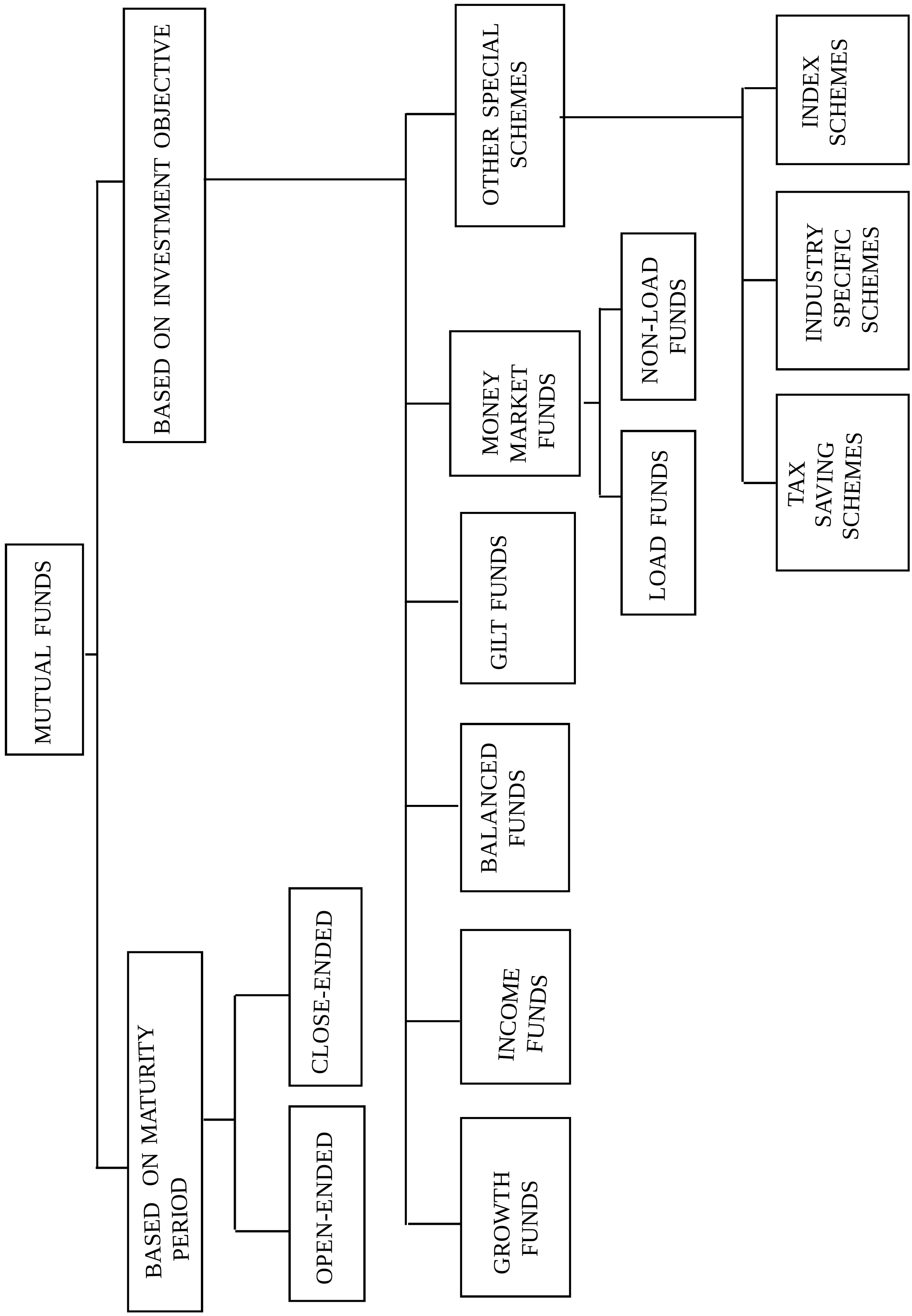
10. Variety of Schemes: - Mutual Funds offer a variety of schemes to suit one's varying needs over a life time.

11. Well Regulated: - All Mutual Funds are registered with SEBI. SEBI monitors the operations of Mutual Funds on a regular basis.

14.3 Types of Mutual Funds:

Mutual Fund schemes can be categorised based on maturity period and investment objectives. Following chart gives clear picture of types of Mutual Funds.

FIGURE - 1


MUTUAL FUNDS
BASED ON MATURITY PERIOD
OPEN-ENDED
CLOSE-ENDED
BASED ON INVESTMENT OBJECTIVE
GROWTH FUNDS
INCOME FUNDS
BALANCED FUNDS
GILT FUNDS
MONEY MARKET FUNDS
LOAD FUNDS
NON-LOAD FUNDS
OTHER SPECIAL SCHEMES
TAX SAVING SCHEMES
INDUSTRY SPECIFIC SCHEMES
INDEX SCHEMES

14.3.1 Mutual Funds Based on Maturity Period:

Based on maturity period, the Mutual Funds may be open-ended or closed-ended.

OPEN-ENDED: - This type of funds do not have a fixed date of maturity. Investors can sell and purchase these units at Net Asset Value related prices declared on a daily basis. These schemes provide liquidity to the funds.

CLOSE-ENDED: - These funds have a defined date of maturity period ranging from five to seven years. The fund is open for subscription only for a specified period. Therefore, if they want to buy or sell, they can do so through stock exchange where they are listed.

14.3.2 Mutual Funds Based on Investment Objectives:

Mutual funds can be classified based on investment objective into six types. Such schemes may be open-ended or close-ended in nature.

1. Growth Funds: - Growth Funds are associated with high risks. These funds normally invest a significant portion of their funds in equities and provide different options to investors such as dividend options, capital appreciation options etc. the main aim of Growth Funds is to provide capital appreciation.

2. Income Funds: - Income Funds invest a significant portion of their funds in fixed income securities such as bonds, corporate debentures, Government securities. These funds aim at providing a regular and steady income to investors.

3. Balanced Funds: - These schemes periodically distribute a part of their earning and invest in both equities and fixed income securities in a given proportion as mentioned in their offer documents. These funds aim at providing growth and regular income to the investor.

4. Gilt Funds: - Gilt Funds invest exclusively in Government securities, such funds have less risk. The NAV's of such funds also fluctuate when there is change in interest rates.

5. Money Market Funds: - Money Market Funds are also called Liquid Funds. These funds aim at providing easy liquidity, preservation of capital and moderate income. For example treasury bills, certificates of deposits, Government securities etc. These are two types –

    I. Load Funds – Load Funds charge 1 to 2 percent commission on entry or exit.

    II. Non-Load Funds: Non-Load Funds do not charge any commission for entry or exit. The advantage of a Non-Load Fund is that the entire corpus is put to work.

6. Other Special Schemes: -

    I. Tax Saving Scheme: - Under these schemes, the investors are entitled to tax rebates under specific provisions of the Indian Income Tax Act, 1961. Under section 88 of this Act, the Government offers tax incentives, such as deduction in respect of investments made in Equity Linked Savings Schemes and Pension Schemes.

II. Industry or Sector Specific Schemes: - These schemes invest their funds only in the sectors or industries specified in the offer document. The investments of these funds is limited to the specific industries such as software, petroleum stocks, fast moving consumer goods etc.

III. Index Schemes: - These schemes invest in the securities in the same weight age comprising an index. Example:- BSE Sensitive Index (Sensex).

14.4 Management of Mutual Funds

In India the only mutual fund operating for a long time, since 1964 was the UTI. It is an open-ended Mutual Fund, whose units can be sold and repurchased at any time. It is in the Public Sector, enjoying a monopoly position and some unique tax benefits such as exemption from income tax. As on March end 2005, there were 9 Public Sector Mutual Funds and about 35 Private Sector Mutual Funds in addition to UTI. Private Sector Mutual Funds were permitted from 1993 only. The SEBI formulates policies and procedures on Mutual Funds to protect the interests of investors. It notified regulations for the mutual funds in 1993.

Mutual Fund industry grew strong since then shifting its focus to other issues such as how to increase asset base and investor base with a large variety of customised schemes. They showed transparency in their operation and thus gained the trust and confidence of the investors. With these positive measures, the Mutual Fund operators slowly attained the status of the industry under the aegis of the Association of Mutual Funds of India (AMFI). Many Mutual Funds have their own websites and these provide a common platform for the investors and fund operators to discuss difficulties, opportunities and compulsions frankly and openly.

The table below gives a picture of resource mobilisation by Mutual Funds over the last decade.

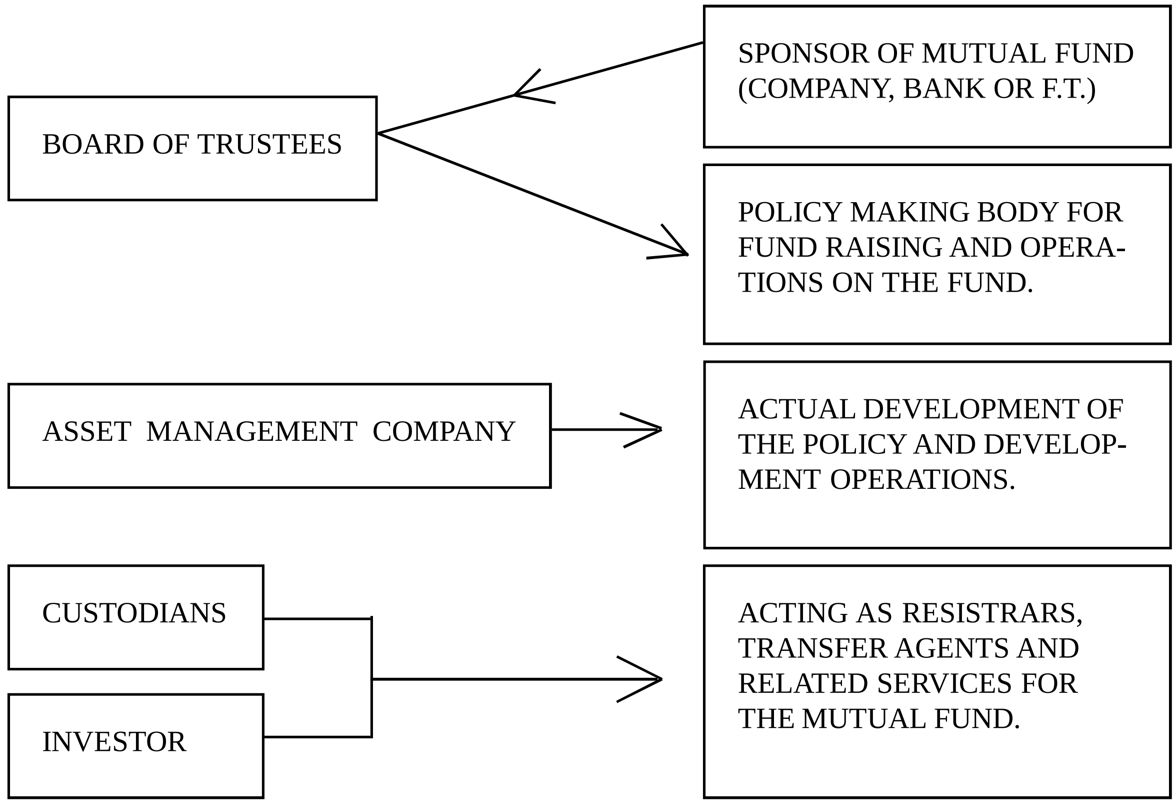
TABLE - 1

(RS. IN CRORES)

YEAR	UTI	Public Sector MFs	Private Sector MFs	TOTAL
1990-91	4,553	2,956	-----	7,509
1993-94	9,297	385	1,560	11,243
2000-01	1,999	1,623	9,717	13,339
2002-03	-9,434	1,988	12,026	4,580
2004-05	-2,722	-2,677	7,600	2,201

The legal structure and organisation of Mutual Funds as laid down by SEBI guide lines is as follows

FIGURE - 2
ORGANISATION OF MUTUAL FUNDS



14.5 Securities and Exchange Board of India (SEBI):

SEBI is a short form for Securities and Exchange Board of India, which is the supervisory and regulatory authority for the stock and capital markets. It was set up in 1988 and was granted legal powers in February 1992. It is a body to setup by the Government as an autonomous organisation to regulate and develop the stock and capital markets and promote investor protection in India.

14.5.1 SEBI – AIMS:

1. To Control and Regulate the stock exchanges and stock brokers.
2. To Regulate Merchant Bankers, Mutual Funds and other players in the Capital Market.
3. To develop Stock and Capital Markets in the right direction.
4. To authorise Brokers and Sub-Brokers and other intermediaries operating in the Capital Markets.
5. To ensure investor protection.

14.5.2 SEBI – Functions:

SEBI performs the following functions to promote the development and regulation of the securities market : -

1. regulating business in stock exchanges.
2. registering and regulating the working of stock brokers, sub brokers, share transfer agents, bankers to issue, trustees of trust deeds, merchant bankers, underwriters, and other intermediaries.
3. registering and regulating the working of depositories, participants, custodians of the securities, foreign institutional investors etc,
4. registering and regulating the working of collective investment schemes, including Mutual Funds and Venture Capital Funds.
5. promoting and regulating self-regulatory organisations.
6. prohibiting unfair trade practices.
7. regulating substantial acquisition of shares and take over of companies.
8. prohibiting insider trading in securities.
9. conducting enquiries and audits of the stock exchanges.
10. promoting investor education and training of intermediaries in the securities market.

14.5.3 Achievements of SEBI:

The following are the major contributions of SEBI

1. The level of corporate Governance could be enhanced.
2. Accounting standard, of firms and intermediaries have been improved.
3. The process of dematerialisation and scripless trading has been accelerated.
4. 'No delivery' period on the stock exchanges has been reduced.
5. Rolling settlement system has been introduced.
6. Transaction costs have been gradually reduced through rationalisation of margins system.
7. Trading in debt securities has been introduced.
8. Granting freedom to companies to issue shares in any denomination but not below Re. 1.

14.6 Role of Sebi in Controlling Capital Market

SEBI achieved remarkable progress in regulating capital markets since 1992. It was setup with the twin objectives of

1. Developing Capital Market.
2. Protecting Investors' Interests.

It has been constantly taking new initiatives to develop capital markets properly and effectively. SEBI is working at increasing market transparency, improving the standards of corporate governance and market efficiency, reducing transaction costs and enhancing the market safety.

Over the last nine years SEBI has taken major policy initiatives for the development of the securities market. At a glance the role of SEBI in capital market is -

1. increase market transparency.
2. improve disclosure standards.
3. improve the standards of corporate governance.
4. improve market efficiency.

SEBI has been successful in terms of setting up a mature regulatory frame work and establishing a proper monitoring system through its market surveillance. But the result is not evident because factors such as sluggish markets world wide, cross border complexities, impact of other financial markets like currency, commodities and property etc. exist in practice. There is still some cases where some of the share brokers and other market players have been taken the capital markets for a ride. In this context SEBI framed some Norms such as

1. SEBI has prohibited the Portfolio Manager to assume any risk on behalf of the client.
2. Portfolio Manager cannot also assure any fixed return to the client.
3. The investments made or advised by him, are subject to risk which the client has to bear.
4. The investment consultancy and management has to be charged at rates which are fixed at the beginning and transparent as per the contract.
5. No sharing of profits or discounts or cash incentives to client is permitted.
6. The Portfolio Manager is prohibited to do lending, badla financing and bills discounting as per SEBI Norms.
7. Client's money has to be kept in a separate account with the Public Sector bank and cannot be mixed up with his own funds or investments.
8. A separate ledger account is maintained for all purchases/sales on clients' behalf, which should be done at the market price.

14.7 Summary:

A Mutual Fund is a trust that pools together the savings of a number of individual or corporate investors who share a common financial goal. Mutual Fund is formed and registered as a trust. It has sponsors, trustees, Asset Management Company (AMC) and custodian. AMC must be approved by the Securities and Exchange Board of India SEBI to manage the funds of the trust. Based on maturity period, the Mutual Funds may be open-ended or closed-ended. Based on investment objectives the Mutual Funds are categories as growth funds, income funds, balanced funds, money market fund gilt funds and index funds. To regulate the functioning of mutual funds, the SEBI issued clear cut guidelines in regulating mutual funds in respect of the registration of mutual funds, appointment of trustees, rights and obligations of the trustees, appointment of custodians, winding up, investment objective, under writing of securities etc.,.

14.8 Glossary:

<u>Portfolio</u> - The list of securities that the Mutual Fund prefers to invest is called portfolio.

<u>Corpus:</u> $\longrightarrow$

Seriples Trading: →

SEBI – Securities and Exchange Board of India.

AMC – Asset Management Company.

14.9 Self Assessment Questions:

14.9.1 Five Marks Questions:

1. What is Mutual Fund? What are its features?
2. Close-ended Scheme.
3. Entry and Exit Costs.

14.9.2 Ten Marks Questions:

1. Explain Merits of Mutual Funds?
2. Explain the SEBI regulations on Mutual Funds?

14.9.3 Twenty Marks Questions:

1. Explain the role of SEBI in regulating Capital Market?
2. Explain different types of Mutual Funds?

14.10 Books Recommended:

1. Industrial Organisation and Management.
   -A.R.Aryasri.
   -V.V.Ramana Murthy.
2. Securities Analysis and Portfolio Management.
   -V.R.Avadhani.

- Dr.K.Kanaka Durga.

LESSON - 15

FUNCTIONS OF MANAGEMENT

15.0 Objectives:

After studying this lesson you should be able to understand the following-

- ➔ What is Management.
- ➔ Different dimensions of Management.
- ➔ Importance, principles and functions of Management.

Structure

15.1 Introduction:

Good Management produces sound results. Management as a function or a process is necessary for organisations, whether they are business organisations or non-business organisations. This is so because persons working within an organisation need some responsible individual to direct activities so that human and material resources may be effectively used to achieve given ends, that responsible individual is the manager who manage and exercise leadership. The manager matches human resources (talent, skill) with non human resources (plant, material, money etc.,). The manager's job is basically the same at all levels in the management hierarchy.

15.2 Different Dimensions of Management:

Following are the important dimensions of management-

1. <u>Management as an Economic Resource</u>: - Management is a vital factor of production. It transforms the various resources into a productivity entity. The input of labour, capital and materials do not by themselves ensure growth. They require the catalyst of management to produce results. It is management that coordinates various factors of production. Therefore, management occupies a central place among productive factors.

2. Management as a Team: - As a team or a group of persons, management consists of all personnel having managerial responsibility. Managers occupy positions at different levels of authority but perform the same basic functions. Top-level managers have greater authority than middle-level managers who in turn have greater authority than operating managers.

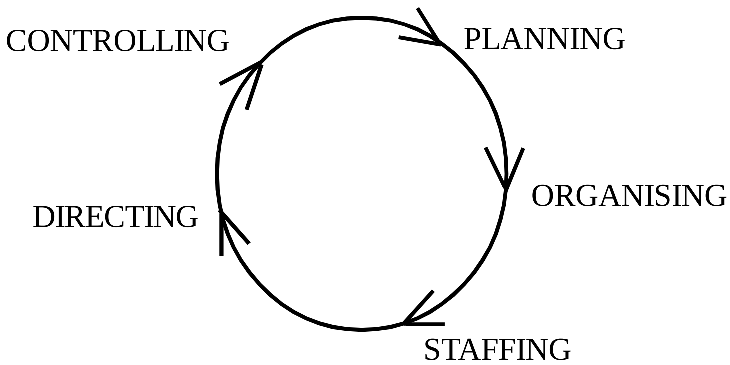
3. Management as an Academic Discipline: - As an academic discipline or field of study, management implies a branch of knowledge. It comprises management theory and principles for tackling managerial problems, and offers a very fruitful and rewarding career.

4. Management as a process: - Management involves organising, directing and controlling human efforts to accomplish predertined goals. As a process, management refers to a series of interrelated elements or functions. This concept of management is the simplest and the most pragmatic. It also highlights the universal nature of management.

5. Management as a human process: - Manager manages different managerial functions planning, organising, staffing, directing, controlling are the functions of management. They rotate like cycle. This is showed in the following diagram-

FIGURE - 1.1

PROCESS OF MANAGEMENT



15.3 Management - Definitions:

Many Management scholars defined management in different ways. Some definitions are given below.

'Louis Allen' defined "Management is what a manager does".

According to 'Harold Koonty' "Management is the Art of getting things done through and with people in formally organised groups".

According to 'Mary Parker Follott' "Management is the art of getting things done through people".

'F.W.Taylor' defined "Management is the art of knowing what you want to do and then seeing that they do it in the best and cheapest way".

These definitions take managerial activities as basis for defining management. Management is the performing of managerial activities for the attainment of enterprise goals. Managerial activities are performed by managers.

15.4 Management Vs Administration

There has been a controversy on the use of the two terms-management and administration. Various authorities have expressed divergent views. Many experts make no distinction between administration and management and use them as synonyms. Several American writers consider them as two distinct functions. A few experts treat administration as a part of management. These three points of view are explained below:

Administration is above management. According to this viewpoint, administration is a top-level function while management is a lower-level function. Administration is a determinative (thinking) function concerned with laying down basic objectives and broad policies of an organisation. On the other hand, management is an executive (doing) function involving the direction of human effort towards the realisation of such objectives. Therefore, managers are often called executives. This view is held by eminent American experts on management.

Administration is a part of management. European School of thought holds that management is a comprehensive term and administration is a part of it. According to E.F.L.Brech, "Management is the generic term for the total process of executive control involving responsibility for effective planning and guidance of the operations of an enterprise. Administration is that part of management which is concerned with the installation and carrying out of the procedures by which the programme is laid down and communicated and the progress of activities is regulated and checked against plans".

Administration and management are one. Henri Fayol, William Newman, Chester Barnard, George R.Terry, Louis A.Allen, Harold Koontz, Cyril O'Donnell and many other writers make no distinction between administration and management. According to William H.Newman, management or administration is "the guidance, leadership and control of the efforts of a group of individuals towards some common goals." Fayol said, all undertakings require the same functions and all must observe the same principles. There is one common science which can be applied equally well to public and private affairs.

The distinction between administration and management is superfluous and meaningless. In practice, the two terms are used interchangebly because both involve the same principles and functions. Somehow, the word management has become popular in business enterprises where economic performance is of primary importance. On the other hand, the term administration is preferred in government departments, hospitals, religious trusts, educational institutions and other non-business organisations.

In order to resolve the terminological conflict between administration and management, management may be classified into:

i) Administrative Management; and
ii) Operative management.

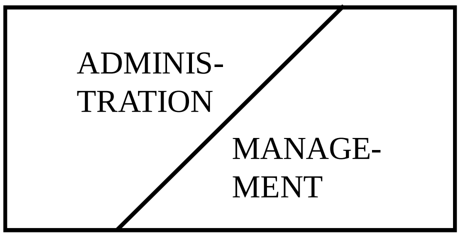
Administrative management involves determination of objectives and policies whereas operative management is primarily concerned with the execution of plans for the achievement of the objectives. At every level of management, an individual manager performs both types of functions.

Every manager spends a part of his time on administrative management and the remaining time on operative management. This can be seen from Fig. 1.2.

FIGURE - 1.2

ADMINISTRATION AND MANAGEMENT COMPARED.

BOARD OF DIRECTORS
MANAGING DIRECTOR
PRODUCTION MANAGER
PLANT SUPERINTENDENT
SUPERVISOR



It is clear from the above figure that higher-level managers spend a major production of their time on decision-making and policy formulation (administration) while lower-level managers spend comparatively greater time on execution of plans and policies (management). But every manager, irrespective of his position or level in the organisation, must plan as well as execute the plans. This approach appears to be more logical because of two reasons. *First*, two separate sets of people are not required to perform administrative and managerial functions. *Secondly*, planning and doing are two faces of the same coin and it is not desirable to separate them.

TABLE - 1.1

DISTINCTION BETWEEN ADMINISTRATION AND MANAGEMENT

S.NO.	*POINTS OF DISTINCTION*	*ADMINISTRATION*	*MANAGEMENT*
1.	NATURE	It is a determinative or thinking function.	It is an executive or doing function.
2.	SCOPE	It is concerned with the determination of major objectives and policies.	It is concerned with the implementation of policies.
3.	LEVEL	It is mainly a top-level function.	It is largely a middle and lower-level function.
4.	INFLUENCE	Administrative decisions are influenced mainly by public opinion and other outside forces.	Managerial decisions are influenced mainly by objectives and policies of the organisation.
5.	DIRECTION OF HUMAN EFFORTS	It is not directly concerned with direction of human efforts.	It is actively concerned with direction of human efforts in the execution of plans.
6.	MAIN FUNCTIONS	Planning and control are the main functions involved in it.	Directing and organising are the main functions involved in it.
7.	SKILLS REQUIRED	Conceptual and human skills.	Technical and human skills.

S.NO.	*POINTS OF DISTINCTION*	*ADMINISTRATION*	*MANAGEMENT*
8.	USAGE	Used largely in government and public sector.	Used mainly in business organisations.
9.	ILLUSTRATIONS	Minister, Commander, Commissioner, Registrar, Vice-Chancellor, Governor, etc.	Managing Director, General Manager, Sales Manager, Branch Manager, etc.

15.5 Importance of Management:

Management is a significant tool for the following reasons:

1. Facilitates achievement of goal: - It facilitates achievement of firms objectives through limited resources. Scarce resources have to be effectively allocated and utilised in an optimum manner.
2. Smooth sailing: - It ensures smooth sailing in case of difficulties. A manager guides the organisation, espically in trouble. He anticipates and makes the necessary changes in the organisation, to achieve the targets.
3. Continuity in Organisation: - Modern organisations are based on systems and procedures. Thus, Continuity is ensured. Organisation do not collapse when some key people leave. But there could be a change in the focus or priorities of the organisation.
4. Economy and efficiency: - Without managers, it may be difficult to get the job performed efficiently. A manager plans, coordinates and monitors the progress of work and suggest whether the work is satisfactory or not. Organisational costs can be minimised through sound management practice.
5. Group efforts: - Management focuses on group efforts chaos will rule an organisation, if each individual is allowed to plan and organise things independently.
6. Economic growth: - Management is the key to economic growth. Efficient management is important for the nation in terms of social and economic development. By providing wealth, managers facilitate the increase in national income and thus, the living standard of the people. Management is thus, key to the economic growth.

15.6 Management: Science, Art or Profession

The controversy with regard to the nature of management, as to whether it is a science or art, is very old. Specification of exact nature of management as science or art or both is necessary to specify the process of learning of management. It is to be noted that learning process in science differs from that of art. Learning of science basically involves the assimilation of principles while learning of art involves its continuous practice.

Much of the controversy of management as science or art is on account of the fact that the earlier captains of the industry and managers have used intuition, hunches, commonsense, and experience is managing organisations. They were not trained professional managers, although they were very brilliant and had developed commonsense through which they managed well. Commonsense and science differ in the following ways:

1. Commonsense is vague as compared to scientific knowledge.
2. Flagrant inconsistency often appears in commonsense whereas logical consistency is the basic of science.
3. Science systematically seeks to explain the events with which it deals; commonsense ignores the need for explanation.
4. The scientific method deliberately exposes claims to the critical evaluation of experimental analysis; commonsense method fails to test conclusions in any scientific fashion.

Science is based on logical consistency,systematic explanation, critical evaluation and experimental analysis. Thus science can be defined as follows:

> Science is a body of systematized knowledge accumulated and accepted with reference to the understanding of general truths concerning a particular phenomenon, subject, or object of study.

Thus science is a systematized body of knowledge. The process of scientific theory construction and confirmation can be viewed as involving the following steps:

1. The formulation of a problem or complex of problems based on observation;
2. The construction of theory to provide answers to the problem or problems based on inductions from observations;
3. The deduction of specific hypotheses from the theory;
4. The recasting of the hypotheses in terms of specific measures and the operations required to test the hypotheses;
5. The devising of actual situation to test the theorem; and
6. The actual testing in which confirmation does or does not occur.

■ Management as Science

Judging from the above features, management is not as exact as natural or physical sciences are. This phenomenon can be explained as follows:

1. Science may be viewed in terms of its structure, its goals, and its methods. The extent a science is mature, such internal consistency may be attained but there are many young sciences like management that only approximate this state.
2. One of the most important rules of science is that concepts have to be defined clearly in terms of the procedures involved in their measurement. One has to know excatly what one is talking about while using a particular term. Meanings have to be clear and unambiguous to avoid confusion and erroneous classification. Since the second decade of this century, a number of disciplines have claimed to contribute to human knowledge of managing. These disciplines have been immature to be a science. The consequence has been almost unfathomable confusion over the various terms, a confusion in which ambivalence in using the various terms has played a conspicuous part.

3. In science, observations must be controlled so that causation may be imputed correctly. This is a difficult rule to follow, specially in studying organisational phenomena.

4. Theories in science are in terms that permit empirical confirmation. Scientific statements are testable and the tests are capable of repetition with same result. Many of the management principles lack empirical evidences and are not testable. Principles in management on the basis of scientific observations which may have universal application, but still the process is in evolutionary stage.

The various factors analysed above suggest that management is not a pure science but it can be simply called 'inexactscience'. This is so because management also makes use of scientific methods in evolving principles. Therefore, it bears partial characteristics of science. In fact, many people have suggested that with greater use of mathematics and statistics in management, the direction is toward more and more use of true science in management. The knowledge consists in how and where to use mathematics in solving issues of managerial difficulty. Science may contribute to the solution of managerial problems in two ways:

i) existing reaserch and theory relevant to the problem may be brought to bear on its solution; and

ii) where sufficient time is available, research may be conducted to provide information not previously available and to guide solution accordingly.

- **Management as an Art:**

Management can be regarded as an art also. The meaning of art is related with the bringing of a desired result through the application of skills. That is, art has to do with applying of knowledge or science or of expertness in performance. The adequate consideration of people involved in managerial action is vital and adds to the concept of art of managing.

Science and art are complementary fields of endeavour; they are not mutually exclusive. The medical doctor requires the knowledge or science of chemistry, biology, and anatomy. Management is an art and a better manager is one who knows how to apply the knowledge in solving a particular problem. Management is an art can be seen from the following facts:

1. The process of mangement does involve the use of know-how and skills like any other art such as music, painting, sculpture, etc.

2. The process of management is directed to achieve certain concrete results as other fields of art do.

3. Management is creative like any other art. Creativity is major dimension in managerial success. It creates new situations for further improvement.

4. The success of managerial task is related with the personality of the man apart from the character and quality of general body of knowledge.

- **Management: Both Science and Art:**

Thus to be a successful manager, a person requires the knowledge of management principles and also the skills of how the knowledge can be utilised. Absence of either will result into efficiency. A comparision between science and art can be presented below which suggests that a manager requires both aspects of management to be successful.

Table - 2
Comparision between Science and Art

Science	Art
Advances by knowledge	Advances by practice
Proves	Feels
Predicts	Guesses
Defines	Describes
Measures	Opines
Impresses	Expresses

It can be seen that management uses both scientific knowledge and art in managing an organisation. As the science of management increases so should the art of management. A balance between the two needed.

- **Management as a Profession:**

Management is regarded as profession by many, although it does not possess all the features of a profession. Therefore, it is desirable to find out whether management is a profession. The word profession has been given a variety of meanings, and different people attach different characteristics to it. Cogan suggests that a profession is "a vocation whose practice is founded upon an understanding of a theoretical structure of some department of learning of science." Both of these definitions merely imply that professions are, in some manner, service occupations and, therefore, valuable to society. However, these definitions do not bring out the characteristics of a profession. Houle has suggested that there are atleast fourteen characteristics that can be associated with the dynamic process of corporate improvement within the occupation (professionalisation). These characteristics are: definition of the occupation's functions, mastery of theoretical knowledge, capacity to solve problems, use of knowledge, self-enhancement, public acceptance, ethical practice, penalties, relations to other vocations, relations to the users of the service. While Houle places these characteristics along a number of different axes-conceptual, performance and collective identity characteristics-he does not really define the concept of profession itself.

The various approaches of defining the characteristics of profession without really defining it is dangerous because characteristics may be added to or subtracted from any existing list by any author without any theoretical rationale. Therefore, an operational definition of profession may be given as follows:

> Profession is an occupation for which specialised knowledge, skills and training are required and the use of these skills is not meant for self-satisfaction but these are used for larger interests of the society and the success of these skills is measured not in terms of money alone.

Thus all professions are occupations in the sense that they provide means of livelihood; however, all occupations are not professions because some of them lack certain characteristics of a profession. The various characteristics of profession may be:

i) existence of an organised and systematised body of knowledge;

ii) formal method of acquisition of knowledge;

iii) existence of an association with professionalisation as its goals;

iv) formulation of ethical codes; and

v) service motives.

Let us discuss the extent to which all these characteristics are found in management to determine whether management is profession or not.

1. Existence of Knowledge: - Profession emerges from the establishment of fact that there is a body of knowledge which cannot be skirted around but has to be studied for being a successful professional. This is true for all professions including management.

2. Acquisition of Knowledge: - An individual can enter a profession only after acquiring knowledge and skills through formal training. For example, only law graduates can enter the profession of legal practice. A professional is one who practises a profession and is regarded as an expert since he has mastery of a specific branch of learning upon which his occupation is based so that he may offer a service to his client. However, the emphasis is put on the initial acquisition of knowledge through some formal method. From this point of view, management cannot be regarded as a profession because the entry to the managerial cadre in an organisation is not limited to management graduates only, though it can be said that management graduates can put better performance in the organisation because of their familiarity with the various techniques of management.

3. Professional Association: - An occupation which claims to be a profession should have an association. A professional association consists of firms and individuals whose membership is based on common professional, scientific, or technical aims. The representative body of professionals is needed to regulate and develop the professional activities.

4. Ethical Codes: - For every profession, some ethical standards are provided and every individual of the profession is expected to maintain conformity with these standards. The need for ethical codes arises because of the fact that occupations whose practitioners have mastery over an area of knowledge have a degree of power by virtue of their expertise and this power can be used for the benefit of the professionals at the cost of the society. This has resulted many occupations issuing a code of ethics of professional practice so that clients may know the standard and commitment that they should receive from a professional. In management also, code of conduct has been formulated to suggest the behavioural pattern for professional managers. Though there is a lack of universally accepted ethical codes for managers throughout the world, in most of the countries, managers are supposed to be socially responsible, and it is their duty to protect the interest of all parties associated with an organisation. In fact, in India, many professional managers are not even aware about the code of conduct formulated by the All India Management Association.

5. Service Motive: - Management is an integrating agency and its contribution in the society by way of integrating various resources into productive units is very important for the stability of the society. This important contribution of management cannot be measured in terms of money alone because without the integrating effort of management, resources worth millions of rupees may be useless.

15.7 Principles of Management:

Fayol recognised a wide spread need for principles of management and for management teaching. In order to acquire managerial knowledge, he developed following principles of management. He has given fourteen principles of management, they are not rigid but flexible.

1. Division of work: - Fayol has advocated division of work to take the advantages of specialisation. According to him, "specialisation belongs to natural order. The workers always work on the same part, the manager concerned always with the same matters, acquire an ability, sureness, and accuracy which increase their output. Each change of work brings in it training and adaptation which reduces output.... yet division of work has its limits which experience and a sense of proportion teach us may not be exceeded." This division of work can be applied at all levels of the organisation.
2. Authority and Responsibility: - The authority and responsibility are related, with the latter the corollary of the former and arising from it. Fayol finds authority as a continuation of official and personal factors. Official authority is derived from the manager's position and personal authority is derived from personal qualities such as intelligence, experience, moral worth, past services, etc. Responsibility arises out of assignment of activity. In order to discharge the responsibility properly, there should be parity of authority and responsibility.
3. Discipline: - All the personnel serving in an organisation should be disciplined. Discipline is obedience, application, energy, behaviour, and outward mark of respect shown by employees.
4. Unity of Command: - Unity of command means that a person should get orders and instructions from only one superior. The more completely an individual has a reporting relationship to a single superior, the less is the problem of conflict in instructions and the greater is the feeling of personal responsibility for results.
5. Unity of Direction: - According to this principle, each group of activities with the same objective must have one head and one plan. Unity of direction is different from unity of command in the sense that former is concerned with functioning of the organisation in respect of its grouping of activities or planning while latter is concerned with personnel at all levels in the organisation in terms of reporting relationship. Unity of direction provides better coordination among various activities to be undertaken by an organisation.
6. Subordination of Individual of General Interest: - Common interest is above the individual interest. Individual interest must be subordinate to general interest when there is conflict between the two. However, factors like ambition, laziness, weakness, etc., tend to reduce the importance of general interest.

7. Remuneration to Personnel: - Remuneration of employees should be fair and provide maximum possible satisfaction to employees and employers. Fayol did not favour profit-sharing plan for workers but advocated it for managers. He was also in favour of non-financial benefits though these were possible only in the case of large-scale organisations.

8. Centralisation: - Everything which goes to increase the importance of subordinate's role is decentralisation; every thing which goes to reduce it is centralisation. Without using the term 'centralisation of authority', Fayol refers the extent to which authority is centralised or decentralised. Centralisation and decentralisation are the question of proportion. In small firms, centralisation is the natural order, but in large firms, a series of intermediaries is required.

9. Scalar Chain: - There should be a scalar chain of authority and of communication ranging from highest to the lowest. It suggests that each communication going up or coming down must flow through each position in the line of authority. It can be short-circuited only in special circumstances when its rigid following would be detrimental to the organisation. For this purpose, Fayol has suggested 'gang plank' which is used to prevent the scalar chain from bogging down action.

10. Order: - This is a principle relating to the arrangement of things and people. In material order, there should be a place for everything and every thing should be in its place. Similarly, in social order, there should be right man in the right place. This kind of order demands precise knowledge of the human requirements and resources of the organisation and a constant balance between these requirements and resources. Normally, bigger is the size of the organisation, more difficult this balance is.

11. Equity: - Equity is the combination of justice and kindness. Equity in treatment and behaviour is liked by every one and it brings loyalty in the organisation. The application of equity requires good sense, experience, and good nature for soliciting loyalty and devotion from subordinates.

12. Stability of Tenure: - No employee should be removed within short time. There should be reasonable security of jobs. Stability of tenure is essential to get an employee accustomed to new work and succeeding in doing it well. Unecessary turnover is both cause and effect of bad management.

13. Initiative: - Within the limits of authority and discipline, managers should encourage their employees for taking initiative. Initiative is concerned with thinking out and execution of a plan. Initiative increases zeal and energy on the part of human beings.

14. Esprit de Corps: - This is the principle of 'union is strength' and extension of unity of command for establishing team work. The manager should encourage esprit de corps among his employees.

15.8 Functions of Management:

The process of management encompasses certain functions to be performed in a logical sequence. While Koontz identified planning, organising, staffing, directing and leading, and controlling as major functions, other management thinkers suggested more or less the same with slight changes.

For instance, Luther **Gulick** coined a new term 'POSDCORB' which is: P-planning, O-organising, S-staffing, D-directing, Co-controlling, R-reporting and B-budgeting. Gulick emphasised two additional functions-*reporting* (a manager has to report to his boss and, hence, reporting dynamics have to be considered) and also *budgeting* (every manager has to prepare a budget for the department).

Henri Fayol lists five functions as elements of the management process-planning, organising, commanding, coordinating and controlling.

It can be concluded that the functions of a manager are planning, organising, staffing, directing (which includes leadership, motivation, communicating and coordinating) and controlling. These are discussed below:

Planning It is the process of deciding now what is to be done in future. It bridges the gap between the present and the future. Corporate goals set the direction for planning.

Planning involves essentially four stages:
(a) identifying the goal to be achieved,
(b) exploring the course of action available to reach this goal,
(c) evaluating each course of action, and
(d) finally, selecting the best course of action for implementation.
In other words, *planning ends with selection or decision making*.

Planning is also referred to as the process of determining *the best course of action to achieve given goals,* it is unlikely that an organisation's goals can be achieved. If its activities are not planned properly. The complexity of the business environment adds fuel to fire. In other words, it makes the function of planning more vital.

To protect the organisation from such an uncertainty, plans should be *flexible* enough to consider the contingencies. The planning function is performed throughout the organisation and it is said to be *all-pervasive*. The best way of ensuring performance is to ensure that people 'know' the plans drawn to achieve the targets.

Organising Organising refers to the process of grouping related activities and assigning them to a manager with the authority to supervise it. Organising is an essential function that makes the plans operational by identifying and classifying the necessary activities. Responsibility is fixed on every manager for the achievement of the plans. Fayol explains superior-subordinate equations. Organising shows how to achieve a *task* with the given resources. It paves the way for formal communication.

Organising makes the organisational environment more conducive for group effectiveness. Well-defined authority and responsibility are tools to evaluate one's performance at work. The function of organising provides the manager enough flexibility to create higher managerial positions that the employees would want to achieve!

Staffing Organisational structure is a tool to explain how many positions there are in an organisation and at what level. The next task is to figure out what type of candidates are required for each position and accordingly fill these with the right people. Staffing is a process which includes recruitment, selection, training, placement, appraisal, promotion and career planning. A manager does all these in small organisations. But in larger organisations, the personnel department looks often these functions led by a qualified professional manager called personnel manager.

Directing After filling the positions, it is important to guide and enable the people to achieve the common goals of the organisation. Directing is a process of issuing orders and instructions to guide and teach the subordinates in the proper methods of work and ensuring that they perform their jobs as planned. The role of a manager is simplified if the goals and objectives of his subordinates match with those of the organisations. In the process, the manager has to lead, motivate, communicate and coordinate their efforts to achieve the corporate goals. In othe words, a manager has to perform the following while directing the members of his group:

- **Leading:** It is a decisive function of the management in which workers/employees are led and directed so that the objectives of the organisation are successfully achieved. It is likely that the workers will work willingly and enthusiastically if they like their leader. An effective manager should also be an effective leader. To be effective, the leader should understand his/her followers well and accordingly assume an appropriate style of functioning: authoritarian or democratic.

- **Motivating:** The process of encouraging an employee to perform more effectively using his abilities and full potential is called motivation. This happens when his social and psychological needs are met, which contribute to organisational goals. Different factors motivate different people. These can be broadly categorised into two types: (a) financial and (b) non-financial. The following are some prominent factors to motivate employees on the work front:

  Financial factors include a competitive salary package which includes monthly/annual salary, perquisites, bonus, overtime, allowances, reimbursement of medical and telephone bills etc.

  Non-financial factors include appreciation from the top, congenial work environment, career growth, minimal supervision, flexible working hours, opportunity to work on live projects (as in the case of R&D and software companies), team building and self-managed work teams.

- **Communicating:** It is the process of creating, transmitting and interpreting messages, ideas, facts, opinions and feelings. The vital function of the manager is to communicate to his staff what they should do through orders, meetings, circulars and notices. Communication is always a two-way process. An important part of the communication process is feedback.

  It is necessary to overcome the usual barriers (resulting from status differences, fear, or emotions, bias, lack of trust etc.) to communication by ensuring a free flow of information through reports, memos, instructuions or personal briefings etc. Employee productivity is often affected adversely because the management fails to communicate its expectations to employees. Absence of free flow of information leaves the employees misunderstood, disappointed, frustrated and finally, separated from the organisation.

- **Coordinating:** Organisational structure provides for division of labour. This calls for linking the different parts of the organisation in terms of their performance to help achieve the given goals. Coordination refers to the process of arranging group efforts in such a way that the common purpose is achieved effectively and efficiently.

  When an employee is elevated to a managerial position, he is not just involved in doing his own work. His job is now concerned with 'coordinating' the efforts of other people and resources under his command. Excellent results come from good coordination.

- **Controlling:** It is the process of measuring the current performance of the employee and assessing whether the given objectives are achieved or not. It involves (a) measuring the actual performance of the employee; (b) comparing it with the target; and (c) taking followup action-corrective or remedial-for improving the performance.

15.9 Summary:

The term Management is viewed as a function, a process or a body of people at the top level in the organisation. As a function, it covers all the activities of a manager. As a process, it covers designing and maintaining an environment that is helpful to acomplish a company's aims. Management is defined as a social process of planning, organising, coordinating, commanding and controlling for the purpose of achieving organisational goals by using limited resources effectively and efficiently. Administration and Management are closely related. Henry Fayol suggested Fourteen principles for effective working of management. Management functions are considered ubiquitous because all these are performed in an organisation at every level, though in varying degrees.

15.10 Glossary:

1. Profession: Means of livelihood.

2. Planning: It bridges the Gap between where we are where we want to go.

3. Administration: Decision making function.

4. Management: Execution function.

15.11 Self Assessment Questions:

- **Five Marks Questions:**

1. Define Management?

2. What is meant by Administration?

3. Explain 'Management is an art'.

- **Ten Marks Questions:**

1. Differentiate Management from administration?
2. Explain importance of Management?
3. What are the different dimensions of Management?

- **Twenty Marks Questions:**

1. What is Management? What are its functions?
2. Explain Henry Fayol principles of Management?
3. 'Management is an art, science or profession'. Explain.

15.12 Books Recommended:

1. Industrial Organisation And Management.
- A.R.Aryasri
- V.V.Ramana Murthy

2. Management Theory & Practice.
- C.B.Gupta

3. Principles And Practice Of Management.
- L.M.Prasad.

- Dr.K.Kanaka Durga

Lesson - 16

MANAGEMENT APPROACHES

16.0 Objectives : After studying this lesson you should be able to understand the following concepts.

- Different approaches to the study of Management.
- Evolution of Management thought

Structure

16.1 Introduction :

The pattern of management has been undergoing change with the varying social, economical, political and technological factors. Industrial Revolution brought out the necessity of developing a theory of management. The management thought has passed through various stages to reach its present level. For the purpose of study it is divided into three stages, each covering different period and ideology of the contributors

Stages In Management Thought :

I . The Classical Theory of Management : In this stage three streams of thought are identified.

1. Scientific management - F.W.TAYLOR - 1910
2. Process management - Henry Fayol - 1910
3. Bureaucratic Mode - Max Webber - 1900

II. The Neo- classical Theory : It consists of two streams of thought.

1. Human Relation Movement -- Elton Mayo and Roethlis berger - 1930.
2. Behavioural Science Movement -- Maslow, Mc Gregor - 1940.

III. The Modern Management Theories : It comprises of three streams of thought.

1. Quantitative Approach - Taylor - 1950.
2. Systems Approach - Boulding, Johnson - 1950
3. Contingency Approach - Lonsch, Lawrence

16.2.1 Classical Approach :

Classical approach are divided into three categories they are :

A. Scientific Management :

F.W. Taylor was the father of Classical approach of Management. He was joined Midvale steel works in Philadelphia, U.S.A. in 1978 as a mechanist and was rose to the Chief engineer position. He was well known as father of Scientific Management. Through his experience in different capacities in the organisation., Taylor found that :-

- Methods of production lacked planning.
- Tools and equipment were meagre and odd.
- Working Methods were haphazerd.

He made efforts to replace the primitive methods by modern scientific methods based on investigation, analysis and measurement.

He defined management as “It is the art of knowing exactly what you want men to do and seeing that they do it in the best and cheapest way”.

Taylor gave the following Scientific Principles for efficient management.

1. Every job should be broken into elements and a scientific method to perform each element should be established.

2. Workers should be Scientifically selected, trained with right attitude.
3. Management should cooperate with workers to ensure that all work is done in accor dance with the Scientific principles.
4. The work and responsibility should be scientifically distributed between workers and management.

B. <u>Administrative or Process Approach</u> :

Father of Administrative approach was Henry Fayol (1841 Born). He stared his career as a junior engineer in a coal mine company in France and became its general manager in 1980. He wrote a book on General and Industrial Management in 1916 which was published in English in 1949.

Henry Fayol observed that management was an activity common to all human undertakings whether in the home business or government. He divided all activities of a business enterprise into six categories :-

1.Technical activities - Production.
2.Commercial activities - Buying, selling and exchange.
3.Financial activities - Search for and optimum use of capital.
4.Security activities - Protection of property and persons.
5.Accounting activities - including statistics.
6.Managerial activities - Planning organising, directing, coordination and control.

C. <u>Bureaucratic Approach</u> :

Beurocratic approach was evolved by a German sociologist, Max Webber. It visualises a machine model of organisation characterised by a hierarchy of authority, a web of rules and regulations and impersonal control over human beings. Bureaucraties are neither good nor bad. They are good organisational forms in some situations, and they are bad in others.

Features of Bureaucracy : According to Max Webber under a bureaucracy the organisation structure has the following features :

i) tasks are divided into very specialized jobs and a rigorous set of rules must be followed

ii) to insure predictability and eliminate uncertainity in task performance.

iii) a stable and well defined hierarchy of authority ensuring clear authority-responsibility relationships.

iv) Superiors take an impersonal attitude in dealing with subordinates.

v) specified qualifications for individuals holding office.

vi) employment and promotions based on merit.

16.2.2 Human Relations Approach or Neo Classical Approach :

Human Relations approach is also known as Neo classical approach. This approach was highlighted by the famous experiments conducted at the Hawthorne plant of the western Electric company during the late 1920's and early 1930 's by a team of researchers from the Harward University. The direct result of the Hawthorne studies was the development of the field of human relations. Human relations may be described as "the study of human behaviour work in order to develop higher levels of productivity and satisfaction.

Elton Mayo, the director of the Hawthorne studies, is generally considered to be the father of the human relations school. The Hawthorne studies provided evidence that an organisation not merely a formal arrangement of men and functions more than that it is a social system which can be operated successfully only with the application of the principles of Psychology and other behavioural sciences. The main aspects of the behavioural science approach are :

a) Employee Motivation : Which includes a determination of the factors that lead to high productivity and high morale.

b) Organisation as a Social System : It includes studies or role, status and status symbols as also the functions of informal groups.

c) Leadership : It involves the study of successful and unsuccessful managerial behaviour.

d) Communication : It includes the study of factors related to achieving understanding between persons in an organisation as a consideration of the best structuring and use of the channels of contract in an organisation.

e) Employee development : It is concerned with the continued upgrading of employee skills and managerial skills.

16.2.3 MODERN MANAGEMENT APPROACH

Modern Management Approaches are divided into two. They are Systems Approach, Contingency Approach.

1. Systems Approach : The General Systems Theory was applied to organisation and management during the fifties. Many Pioneers such as Kenneth Boulding, E.L.Trist,R.A. - Johnson and Chester Barnard have made significant contribution towards the development of the systems approach to management. A system is a set of distinguishable but interdependent and interrelated parts operating in a logical manner or sequence in order to achieve a goal. Each part affects the others and the system as a whole. Every system operates within a wider system. A system is goal oriented and operates in a logical manner in accordance with some plans.

2. Contingency Approach :- Contingency approach is also known as situational approach. It is new approach to management. It is an extension of the systems approach. The basic theme of the contingency approach is that organisations have to cope with different situations in different ways. In order to be effective, the internal functioning of an organisation must be consistent with the demands of the external environment.

Features : The main features of the contingency approach are as follows :

i) Management is entirely situational. The conditions and complexity of the situation determine which measure or technique is applicable and effective.

ii) Management should, therefore, match or fit its approach to the requirements of the particular situation. The organisation structure, the leadership style, the control system all should be designed to fit the particular situation.

iii) Since management's success depends on its ability to cope with its environment. It should sharpen its diagnostic skills so as to anticipate and comprehend the environmental changes.

iv) Managers should understand that there is no one best way to manage. They must not consider management principles and techniques universal.

The contingency approach is the outcome mainly of the research studies conducted by Tom Burns and G.W. Stalker, Joan Wood Ward etc., These experts analysed the relationships between the structure of an organisation and environmental conditions.

16.3 EVOLUTION OF MANAGEMENT DISCIPLINE :

Management practice is as old as human civilisation when people started living together in groups. For every human group requires management. In the earlier years, management could not get the attention of researchers because the field of business in which the management concepts were applied was held low, unworthy of study; indifferent approach of other social scientists like economists, sociologists, Psychologists etc., towards management and business organisations; treatment of management as an art not as a science and the commonly held belief that managers are born and not made. These factors created the situation where the need for a systematic study of management was not felt this situation continued till the beginning of the twentieth century.

The situation started changing with the beginning of the present century. Growing competition and complexity of managing large business organisations further provided impetus to developing systematic management concepts and principles. The real development of management thought has begun with scientific management approach given by Taylor.

16.3.1 Stages in Management Thought :

The evolution of management thought may be divided into three stages.

1. The Classical Theory of Management
2. The Neo Classical Theory of Management.
3. The Modern Management Theory.

16.4.1 I. The Classical Theory of Management :

The Systematic study of management as a separate field of activity started only during the second half of the 19th century.

In this stage three streams of thought are identified :

A) Bureaucratic model - Max Webber
B) Scientific Management - F.W. Taylor
C) Process Management - Henry Fayol.

A) Bureaucratic Model : Max Webber, a German Sociologist, was the Chief exponent of the Bureaucratic Model. According to him, the recognition and exercise of authority is the fundamental question. According to him Authority Structure is in three types i.e. Chrismatic, Traditional and Bureaucratic.

I. Chrismatic Authority :- A chrismatic leader's authority is accepted by virtue of some exceptional innate qualities. The Chrisma remains with the leader and it is not necessary that the successor too has chrisma.

II. Traditional Authority :- If the Authority structure is based on heredity or procedure and rules, such an organisation will become a traditional.

III. Bureaucratic Authority :- Webber names it rational legal. It is more efficient form of organisation. Because specific objectives of the organisation are laid down and organisation is designed to achieve them and it is legal because authority stemmed from clearly defined rules, roles and procedures.

B) Scientific Management Stage :

Taylor has defined the basic problem of managing as the art of "knowing exactly what you want men to do and then see in that they do it in the best and cheapest way. Sinnce Taylor has put the problem of managing on a scientific way, he is often called as the father of scientific management.

The main features of scientific management are : -

i) Separation of planning and doing.

ii) Functional foremenship which consists of eight persons to direct the activities of workers.

iii) Job analysis to find out the one best way of doing the thing.

iv) Standardisation should be maintained in respect of inspect of instruments and tools, period of work, amount of work and working conditions.

v) Scientific selection and Training of workers.

vi) Financial incentives to efficient personnel.

vii) Mutual co-operation between management and workers.

Organisation Stage : Henry Fayol's contribution to the management thought was divided into three categories they are :

i) Classification of business activities

ii) Functions of Management.

iii) Principles of Management.

i) Business Activities : He divided all activities of a business enterprise into six categories -

a) Technical Activities	-	Production
b) Commercial Activities	-	Exchange
c) Functional Activities	-	Optimum use of capital
d) Security Activities	-	Protection of property & Persons
e) Accounting Activities	-	Preparation of Accounts
f) Managerial Activities	-	Functions of Management

ii) Functions of Management : Fayol divided the key function of administration into five elements -

a) Planning	-	Forecast the future
b) Organising	-	Every thing useful to its functioning
c) Staffing	-	Recruitment and Training
d) Directing	-	Lead the personnel in better way
e) Controlling	-	Ensuring everything goes as per plans.

iii) Principles of Management : Henry Fayol gave the following fourteen principles of management . Such as : 1) Division of work, 2) Authority and Responsibility, 3) Discipline, 4) Unity of Command, 5) Unity of Direction, 6) Subordination of Individual interest to general interest, 7) Fair Remuneration to workers, 8) Effective Centralisation, 9) Scalar Chain, 10) Order, 11) Equity, 12) Stability of tenure, 13) Initiative and 14) Espirit decorps.

16.4.2 II. Neo-Classical Theory :

Neo-classical theory deals with the human factor. Neo-classical approach also causes 'Behavioural Science Management' which is a further refinement of human relations approach. It consists of two thoughts :

i. Human Relations Movement : Human relations movement deals with the factors which encourage higher performance on the part of workers. The improvement of working conditions, reduction of working hours, improvement of social relations of workers, besides monetary gains help in increasing productivity. The contributors are Elton Mayo, Mary Parker Follett.

ii. Behavioural Sciences Movement : Behavioural sciences movement is regarded as a further refinement of human relations movement. It laid emphasis on the application of the methods and findings of general and social psychology and sociology for understanding the organisational behaviour. The important aspects of behavioural approach are -

i. Motivation of employees

ii.Organisation as a social system.

iii. Leadership study of managerial behaviour.

iv. Communication for better understanding.

v. Upgrading of employee and management skills.

The contributors to this thought are Maslow, Mc Gregor, Bernard.

16.4.3 Modern Management Theories :

I. Quantitative Approach :-

It is also known as Mathematical approach. The Management scientists are of the view that if managing or organising or planning or decision making is a logical process. It can be expressed in mathematical symbols and relationships. The development of Technology and the introduction of computers brought mathematics and management closer to each other. The study of problems, their analysis and finding out rational solutions is also due to decision theory's school of thought.

ii. Systems Approach :

The Systems approach looks upon the management as a 'system' or as an 'organised whole' made up of sub-systems integrated into a unit. The main thrust of this approach is on the interdependence and inter-relatedness of the various sub-systems from the point of view of the effectiveness of a larger system.

Contributors to this thought are Bernard, Kenneth, Boulding, Martin etc.,

iii. Contingency Approach : It is also known as situational approach. It was developed by J.W.Lorsch and P.R.Lawrence. The contingency or situational approach emphasises the fact that what managers do in practice depends upon a given set of circumstances. This approach not only takes into account only given situations but also the influence of given solution on behaviour patterns of an enterprise. According to this approach, managers should develop variable methods, tools or action plans as per the specific situation. The type of motivation, communication system, type of leadership in an organisation will depend upon the circumstances prevailing in different enterprises at different times.

16.5 SCHOOLS OF MANAGEMENT THOUGHT :

The various approaches to the study of management as propounded by specialists from different disciplines have come to be called schools of management thought. Management theory can be classified into the following schools of thought.

1. Management Process School : This school considers management as a process of getting things done by people who operate in the organisation. Henry Fayol is the father of this school of thought. The Management process can be divided in five broad functions such as : Planning, Organising, Staffing, Directing and Controlling. It seeks to analyse the nature, purpose, structure and the underlying process of each of these functions.

2. The Empirical School : The empirical or case approach analyses management by studying experiences of people actually managing business. This thinking is based on the belief that the study of actual situation, where success will help the student's and practitioners to know how to manage effectively in similar situations. This knowledge will help managers in taking decisions in different situations.

3. The Human Behaviour School : This approach is based on the idea that managing involves getting things done through people so its study should concentrate on inter personal relationships. The school concentrates on the human aspect of management and the belief that when people work together to accomplish objectives, 'people should understand people'. The relationship among people are the cementing force that bind them together to accomplish common objectives. The main contributors to this school are Elton Mayo, Mc Gregor, Keith Davis. The thinkers of human behaviour approach are of the view that the effectiveness of any organisation depends upon the quality of relationships among the people working in the organisation.

4. The Social Systems School : This thought is closely related to human behaviour school of thought. In this approach, an organisation, could be considered as a social system consisting of various groups of people. The founding father of this school is Chester Bernard. The main contribution of this school of thought is its focus on cultural factors in the working of an organisation.

5. The Decision Theory School : This school of thought is based on the belief that managers make decisions. We should concentrate on decision-making, what ever managers do is the outcome of decisions made by them out of the alternatives available to them. Decisions are important for formulating policies in managing business. The decisions should be taken at right time, should be related to the environment or situation and should be feasible in a given situation. The decisions should be communicated to the right persons so that these are implemented in a right manner.

16.6 SUMMARY :

Thus management has been practised in some form or the other since the dawn of civilisation. Ever since human beings started living together in groups, techniques of organisation and management were evolved. Despite ancient origins, very little conceptual and organised body knowledge was developed in management till the end of 19th century. Systematic study and analysis of management as a science began in the 20th century after the Industrial Revolution. Since then management has developed as a distinct discipline and as a social science. Before the scientific management movement several pioneers, like Robert Owen, Charles Babbage, Henry Vernun Poor, gave some concepts of management.

16.7 Self Assessment Questions :

1. Five marks questions :

1. Explain Beurocratic approach

2. Explain Human relations approach

3. Explain Process approach

2. Ten marks questions :

1. How the Taylor Opinioned on Management.

2. What are the opinions of Henry Foyal on Management thought.

3. Twenty marks questions :

1. Explain various approaches to the study of management.

2. Describe evolution of management discipline.

16.8 Glossary :

Scientific Method - Approaches through Scientific Principles

Morale : It is the willingness of the members of a group to work enthusiastically as a team for the accomplishment of common objectives.

16.9 Books Recommended :

1. Management Theory & practice - C.B. Gupta.

2. Principles and Practice of management - L.M.Prasad.

3. Principles of business organisation & Management - P.N. Reddy.
- S.S.Gulshan.

4. Industrial organisation & management - R.K.Sharma.

- Dr. K.KANAKA DURGA

LESSON - 17

PLANNING

17.0 Objectives:

After studying this lesson you should be able to understand the following

- ➔ What is Planning, what are its features.
- ➔ Relation between Planning and Control.
- ➔ Merits and Demerits of Planning.
- ➔ Types of Plans
- ➔ Strategic Planning.

Structure

17.1 Introduction:

Every human activity undertaken with a view to achieve something must be preceded by planning. For instance, A student desirous of securing a good grade in the examination has to plan his study. A person intending to set up a business cannot do so unless he has done a lot of previous thinking, considered various aspects and taken many decisions if not all. He has to plan within the available resources, the location, the products to be sold, customers to be approached or the markets to be entered.

Managerial operations must be based on suitable and sufficient planning. It is the primary function of management. It has to plan not only in the beginning but throughout the operations.

To plan is to look ahead and chart out the future course of operations. It is the determinant of a course of action to achieve a desired result. It is one of the cornerstones upon which successful enterprise depends.

Planning is meant for-

1. the analysis of a problem
2. thinking out the forward solutions to that problem.
3. outlining the steps that must be taken to reach the objectives.

17.2 Definition of Planning:

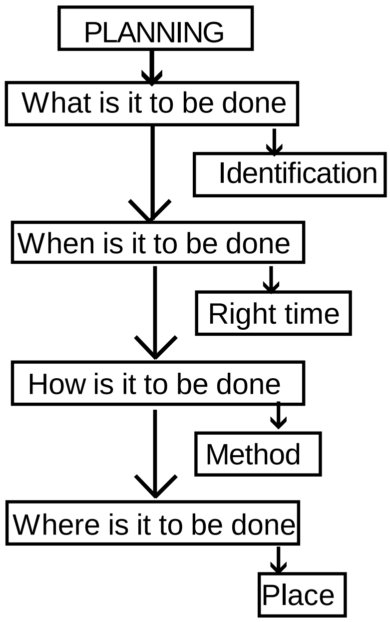
Planning is defined in many ways-

1. Planning is deciding in advance what is to be done.
2. Planning bridges the gap from where we are to where we want to go.
3. Planning will involve deciding a course of action from amongst a number of alternative courses which would help the enterprise to achieve its objectives most expeditiously and economically.
4. Planning ensures proper application of resources for the attainment of desired ends.

Following chart shows stages in Planning.

CHART - 1

STAGES IN PLANNING



17.3 Features of Planning:

The nature of Planning reveals the following features.

a) Goal oriented: - It contributes positively to achievement of mission and goals. It identifies the measures to be taken to achieve the targeted results efficiently and economically.

b) Intellectually a demanding process: - Planning is not mere guessing, one should be capable of thinking in a systematic manner. It is so because planning demands intellectual skills such as vision, foresight, imagination and analytical skills to take rational decisions.

c) Involves choice: - There are alternatives available to achieve a particular target. The manager has to select the best alternative.

d) Basis for other functions: - Since planning is the first function of the manager, the results of planning from the basis for all other managerial functions.

e) All pervasive in nature: - All managers have to plan. Planning is essential for all organisations. Managers at the top, middle and lower levels in any organisation have to systematically plan for the future. Thus, planning is said to be all pervasives.

f) Continuous process: - Since business is complex plan also need to be dynamic. At the end every year plans must be reviewed and new plans prepared for the next year. Thus planning is a continuous process.

g) Flexible in nature: - Plans should not be rigid. They should be flexible in nature and accommodate a change in circumstances.

h) Intends to enhance efficiency: - The aim of planning is to achieve the maximum targets at minimum costs and quickly. So plans should be cost effective and worth their investments.

17.4 Significance of Planning:

1. Managerial planning attempts to achieve a consistent, co-ordinated structure of operations focused on desired ends.

2. Planning overcomes in consistencies, contradictions and duplication of work in the operations of an enterprise.

3. With planning, the structure of operations comprising various activities of an organisation acquires design and shape. Focuses attention on objectives.

4. The planning function brings the manager's attention to focus on the formulation of objectives. It enables the manager to take his mind off the present problems and the headaches.

5. By constant planning, the manager can take care of the future developments.

6. Planning brings economy into operation: - The importance of planning lies in the fact that it ensures, proper application of resources, avoids wastages and they brings economy in operation. Through proper planning resources can be obtained at the most favourable terms.

7. Planning makes control possible: - Control cannot be exercised without planning with the help of planning. Comparisons can be made. The actual output can be compared the desired one. If there is difference it would be considered. Reasons would be located and necessary action will be taken.

8. Planning helps motivation: - The managers cannot only verify but can encourage workers to attain the targets. When tangible goals are in sight it is easier to encourage the workers to reach those levels.

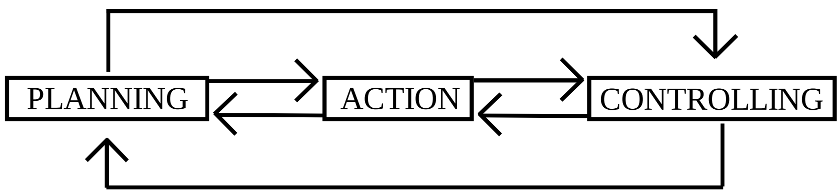
9. Planning ensures against failures and set backs: - Planning is based on estimates. It is an effort to visualise the future and attain goals through present action.

17.5 Relation Between Planning and Control:

Planning is the first function of management, whereas controlling is the last one. Planning is difficult with controlling. Controlling is base for the preceding years plans. In the planning stage managers decide how the resources would be utilised to achieve organisational objectives; at the controlling stage, managers try to visualise whether resources are utilised in the same way as planned. Thus control completes the whole sequence of management process. Control is the result of particular plans, goals, or policies. Thus planning offers and affects control . Not only the planning is also affected by control in the sense that many of the information provided by control is used for planning and replanning. Thus there is a reciprocal relationship between planning and control. This relationship is presented in the following figure.

FIGURE - 1

PLANNING AND CONTROLLING RELATIONSHIP



17.6 Advantages of Planning:

Folliwing are the advantages of Planning.

1. Minimises Uncertainity: - Planning certainly minimises future uncertainities by basing its decisions on past experiences and present situations.

2. Better Utilisation of Resources: - All the resources are first identified and then operations are planned. All resources are put to best possible uses.

3. <u>Economy in Operations</u>: - The objectives are determined first and then possible course of action is selected for achieving these objectives. The operations selected being better among possible alternatives, there is an economy in operations.

4. <u>Better Co-ordination</u>: - Planning will lead to better co-ordination in the organisaion, will ultimately lead to better results.

5. <u>Encourages Innovation</u>: - Planning helps innovative and creative thinking among managers because they will think of many new things while planning.

6. <u>Management by Exception Possible</u>: - Planning fixed objectives of the organisations and all efforts should be made to achieve these objectives. Management should interfere only when things are not going well. By the introduction of management by exception, managers are given more time for planning the activities rather than waiting their time in directing day-to-day work.

7. <u>Facilitates Control</u>: - Planning will enable the management to check performance of subordinates. The deviations in performance can be rectified at the earliest by taking remedial measures.

8. <u>Facilitates delegation</u>: - They will be requiring requisite authority for getting the things done. Delegation of authority is facilitated through planning process.

17.7 Limitaions of Planning:

Despite of many advantages of Planning, there may be some obstacles and limitations in this process. The following are some of the limitations of planning.

1. <u>Lack of Reliable Data</u>: - Planning is based on various facts and figures supplied to the planners, which are difficult to procure Absence of accurate data will upset the plan.
2. <u>Expensive</u>: - Planning is an expensive process. The gathering of information and testing of various courses of action, setting up the planning machinery, appointment of staff for the collection of data, analysis, editing, formalation of hypothesis require huge amount of money. Small concerns can not afford to use planning.
3. <u>Time Consuming Exercise</u>: - As planning involves a number of steps, a lot time has to be devoted to plan before actual operations start.
4. <u>Lack of workers initiative</u>: - Under planning exercise worker has to act only mechanically. It robs him of his interest in the work.
5. <u>External Factors may ReduceUtility</u>: - Besides internal factors there are external factors too which adversely affect planning. These factors may be economical, social, political, technological or legal.
6. <u>Psychological Hurdle</u>: - Human psychology also, to an extent, places some hurdles in the success of planning. There is a certain degree of conservatism in people which implies resistance to change.

7. Sudden Emergencies: - In case certain emergencies arise then the need of the hour is quick action and not advance planning. These situations may not be anticipated.

17.8 Making Planning Effective:

The question is not whether to plan or not, but the question is how well to plan. Therefore, managers should take adequate precautions to make planning activity more effective to gain its real contributions in realising organisational objectives. However, it is not sufficient to say that managers should take action to make planning effective, but they should be clear about what actions can be taken in this regard. Following factors are important to planning more effective.

1. Establishing Climate for Planning: - Every superior should remove obstacles to planning and present facilities for planning. This can be done by setting goals, establishing and publishing planning premises. Involving all managers in planning process, reviewing subordinates' plans and their performance, and ensuring that managers have appropriate staff assistance and information.

2. Initiative at Top Levels: - The role of Top management in planning process is quite unique and important. It is the top management which is responsible for the success or failure of any organisational process and planning is no exception. For planning process, basic goals from which others stem must be organisation-wide and therefore goals must be set at the top management level. Effective planning may start at the top level and get support from lower level managers. There is some thing to encouraging an upward push as well as a downward press.

3. Participation in Planning Process: - The best planning is likely to be done when managers are given opportunities to contribute to plan affecting areas over which they have authority.

4. Communication Planning Elements: - Many planning efforts fail because managers do not really understand their goals and other planning premises which affect their planning efforts. In order to avoid this impediment, it is highly desirable. That these aspects of planning are communicated properly. There should be direct communication between various level managers whose planning efforts are directly related. While communicating, it should be borme in mind that information about planning should be specific and clear.

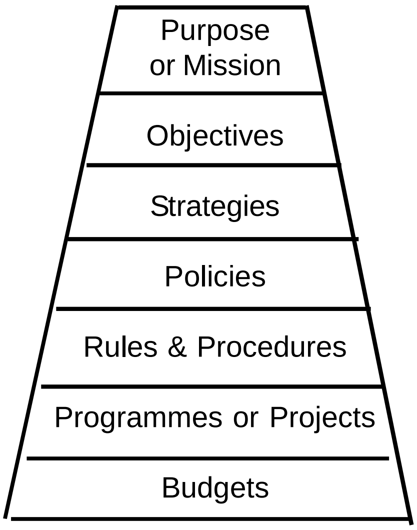
5. Integration of Plans: - Integration of long term and short term plans is necessary that both are fully integrated in which short term plans should be taken as contributing to long term plans.

6. An Open Systems Approach: - Planning can be made effective by taking it as an open systems approach. Objectives, a starting point in planning, should be set taking into account the various environmental forces.

17.9 Types of Plans:

A plan is a commitment to a particular course of action believed necessary to achieve specific results. From this point of view, there can be several types of plans. Various plans in an organisation may be purpose or mission. objectives, strategies, policies, procedures and rules, programmes, and budgets. These can be arranged in a hierarchy because a higher level plan gives or generates lower level plan as presented in the following figure.

Figure - 2
Hierarchy of Plans



Purpose or Mission: - Purpose or Mission is a standing plan in the sense that it defines the basic intention of an organisation in the light at which other actions are designed. The purpose of business is to make profit through purchase and sale of goods just as the purpose at a university is to teach, enable research. A well defined mission or purpose provides inspiration and guidance to employees to do their best in their individual and collective capacities.

Objectives or Goals: - Goals or objectives are different from the over all objectives or basic objectives. Based on the plans, every individual and department in an organisation, has a set of objectives to achieve.

While profit making is the basic objective for the entire organisation through sale of personal computers, the object of production department is to produce a certain configuaration at a certain cost. The objective of a production cell here forms the basis for many other activities in this department objectives thus, form the basis for all functions of management.

Strategies: - Strategies reflect broad areas of an enterprise operation. Strategies are used to determine and communicate the envisioned growth. They make use of basic objectives and broad policies.. Strategies are helpful at both micro and macro levels. They are very useful and important in guiding the planning function.

Policies: - Policies are statements of understanding that specify what ‘can be done or what cannot be done’ to achieve the given objectives. Policies guide the behaviour or thinking of people in an organisation policies are essential in cases where a situation recurs often and the analysis of underlying issues takes a long time. In such cases, managers must be allowed to use their authority and monitor the performance of employees. Policy is a valuable tool at all levels of management.
For example: - ‘Pricing products lower than minimum retail price’ is a policy.

Unless policies are made in a consistent and integrated way, it may not be possible to achieve the over all objectives.

Procedures: - Procedures outline in detail the method of carrying out a task. It is concerned more with execution than thinking. Every organisation formulates procedures to ensure that tasks are performed in a given sequence. The Top management is concerned with the laying down of procedures and the middle and lower levels with their implementation.

For example: - The procedure to settle the account is- Suppliers directly dispatch invoices to the accounts department to settle bills. The accounts department sends it to the stores for verification, then passes the invoice for payment.

Rules: - Rules guide action or non-action on the part of people in organisations. Any non-compliance with rules may invite punishment.

For example: - 'No Credit' is a rule.

'No Smoking' is a rule.

Programmes: - These specify what is to be done. They reflect goals, policies, procedures and rules to be followed, steps to be taken, resources to be employed and even minor details necessary to execute a task. Every programme is supported by a budget. Programmes may be major or minor based on their purpose, scope, and time duration.

For instance: - The programme may be- 'How to compensate the shareholders'.

All programmes need coordination and timing.

Budgets: - When plans are expressed in numbers, they become budgets. A budget may be expressed in financial terms or any other measurable form such as machine hours, labour hours or units produced. It can also be expressed in terms of enterprise activities such as sales budget, advertisement budget, purchases budget, cash budget etc. Budgets are prepared for a clearly defined period, say a week, month or year. It can serve as a better means of control only when it reflects the plans.

17.10 Steps in Planning:

Planning process may differ from plan to plan or from one organisation to another. With minor modifications the process, given below is applicable to all types of plans.

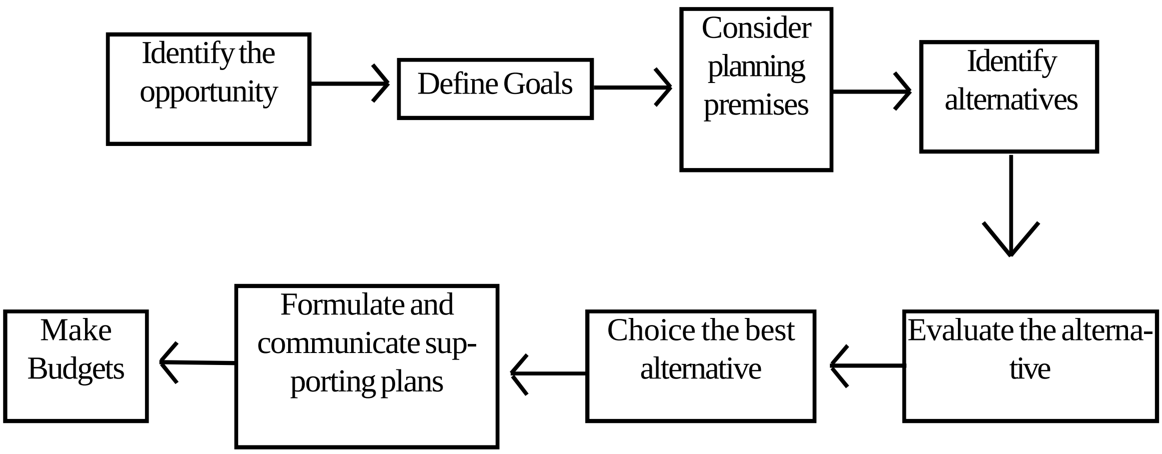


Figure - 3

<u>Steps in Planning Process</u>

1. Identify the oppurtunity: - Real planning starts with knowing the availability of different opportunities. For each opportunity, assess carefully the size of markets, type of customers, degree of competition, needs of customers, finances required and the strengths and weaknesses of the firm. Then, identify the right opportunity.

2. Define goals: - Once the opportunity is identified, define the goals you want to achieve for the entire organisation. Goals, in turn, will throw light on what objectives, strategies, policies, procedures, rules, budgets and programmes you should follow.

3. Consider the planning premises: - Planning premises refers to the assumptions about the environment in which plans have to be carried out. Correct assumptions about markets, competition, product technology, prices, volume of sales, costs, tax rates etc are essential for business planning. Govenment policies, annual budgets, economic indicators, survey of specific industries etc. provide valuable insights on the basis of which 'premises' can be worked out.

   Premises may be *internal or external* to the firm. Internal premises refer to the assumptions about the firm's finances, employees, technology-in-use etc. External premises are assumptions about competitors, lenders, changes in technology, government policies and procedures.

   Premises may be controllable or non-controllable. Managers can exercise control over internal premises but not over the external ones. For instance, a firm can decide about the wages and salaries of its employees but not on the taxes payable. The government determines taxes and the firm has just to follow the prevailing tax rates.

   Premises may be *tangible or non-tangible*. Tangible premises refer to what can be quantified as sales, number of employees etc. Intangible premises refer to what cannot be quantified such as employee morale or the goodwill of the business.

4. Identify alternatives: - There may be more than one alternative to reach a goal or objective. Search for and identify all the available alternatives. Work out the requirement of resources under each alternative. In most cases, finding alternatives may be easier. Shortlisting the promising ones is a relatively complex task.

5. Evaluate the alternatives: - Examine each alternative in relation to the other and identify the merits and demerits of each. One alternative may look very profitable but it may involve a large capital investment and also take longtime to return the original investment. It may also involve a high degree of risk. There may be some good alternatives which cannot be considered even though they fit into the long term interests of the organisation.

   Evaluation of given alternatives is a complicated process as the business environment is full of uncertainties. Government policy may change, technology may change, adequate funds may not be available etc. The alternatives have to be evaluated in the light of many variables and constraints. There are some modern techniques such as operations research and computing which can be gainfully employed in evaluating the given alternatives.

6. Choose the best alternative: - The best alternative is decided on a given situation. Normally it involves optimum utilisation of resources. At times, the number of best alternatives could be more than one. To eliminate errors in judgement, the manager may even decide to follow more alternatives than confining himself to one.

7. Formulate and communicate supporting plans: - Supporting plans are also called derivative plans. These are derived from the best alternative chosen. when a company decides to launch a new product, it also has to formulate several supporting plans for recruiting and training more staff, mobilise more infrastucture and working capital for advertising and insurance. Managers have to communicate these supporting plans to the employees concerned so that they can be involved in their implementation.

8. Make budgets: - Budget is "numerical expression" of a plan. Budgets can be formulated for the entire organisation and also for each department or programme. When cash, sales, production and other budgets are integrated, it results in an overall budget for the entire organisation, popularly known as Mater Budget or Integrated budget. Budget set standards for measuring and controlling the actual performance of the employees in an organisation.

17.11 Strategic Planning:

Strategic planning is also called long term planning. Some parts of the organisation require planning for many years into the future, while others require planning over a short period only. The former is called strategic planning.

'Anthony' defined strategic planning as "Strategic Planning is the process of deciding on objectives of the organisation, on changes on these objectives, on the resources used to attain these objectives and on the policies that are to govern the acquisition, use and disposition of these resources".

Following are the examples for strategic planning in an organisation.

i) Estimation of capital expenditure
ii) Planning growth rate in sales
iii) Diversification of business into new lines,
iv) Type of products to be offered.

■ **Features:**

i) Encompasses fundamental areas: - The strategic planning encompasses all the functional areas of business and it affects within the existing and long range frame work of economic, political, technological and social factors.

ii) Type of Environment: - Strategic planning takes into account the external environment and tries to relate the organisation with it.

iii) Primary: - Strategic planning sets trends and direction for managerial actions.

iv) Formulation: - Strategic planning is formulated usually by top level management and other specified planning staff in the organisation. At this level, managers can take overall view of the organisation and have necessary capability to relate the organisation with the external environment.

- **Merits of Strategic Planning:**

1. Strategic planning involves the analysis of various environmental factors particurlarly with respect to how organisation relates to its environment.

2. Strategic planning guides the choice among the broad directions in which the organisation seeks to move and concerns the general planneel allocation of its managerial, financial and physical resources over future specified period of time.

3. It allocates resources effectively.

4. It identifies the business that helps to meet a mission.

- **Demerits of Strategic Planning:**

1. A basic problem in strategic planning is the period for which plan is to be formulated.

2. Strategic planning is expensive. Organisation should not plan for a longer period than is economically justifiable.

3. The commitment principle implies that long-range planning is not really planning for future decisions but rather planning for the future impact of today's decisions.

17.12 Summary:

Planning bridges the gap between the present and the future. Planning helps managers to do things in an orderly way. It is a managerial function and also an independent process and goal oriented. It forms the basis for other functions. It helps to achieve targets, minimises uncertainty. Identifying opportunity, defining goals, considering the planning identifying alternatives, evaluating the alternatives choosing the best alternative formulating and communicating plans are the steps in the planning process. Objectives, policies, procedures, rules, regulations, programmes, strategies, Budgets are the types of plans. Strategic planning is the process of detemining by the top level management, the ways and means of pursuing long term plans. On the other hand planning is a costly process, it may promote rigid behaviour and tends to be inaccurate.

17.13 Glossary:

1. ***Planning:*** Thinking before doing
2. ***Controlling:*** Comparision of actuals with plans to know the differences, and causes of differences.
3. ***Strategies:*** Strategy is a special kind of plan formulated in order to meet the challenges of competitors.
4. ***Budget:*** A Budget is a plan expressed in numericals.
5. ***Strategic Planning:*** Long term planning.

17.4 Self Assessment Questions:

- **Five Marks Questions:**

1. What is meant by Planning?
2. Relation between Planning and Controlling.
3. Rules Vs Programmes.

- **Ten Marks Questions:**

1. What is Plan? What are its features?
2. Explain the importance of Planning?
3. Explain Strategic Planning?

- **Twenty Marks Questions:**

1. Explain Merits, Demerits and Limitations of Planning?
2. Explain Types of Plans?
3. Explain Stages in Planning?

17.15 Books Recommended:

1. Industrial Organisation & Management.
   - R.K.Sharma & Shashi K.Gupta.
2. Principles of Management.
   - Harold Koonty & Curil O'Donnell.
3. Principles of Management.
   - P.C.Tripathi & P.N.Reddy.
4. Principles of Business Organisation & Management.
   - P.N.Reddy & S.S.Gulshan.

- Dr.K.Kanaka Durga.

LESSON - 18

ORGANISATION

18.0 Objectives:

After Studying this lesson you should be able to understand the following

- ➔ What is Organisation
- ➔ Formal and Informal Organisations
- ➔ Authority, Responsibility, Power
- ➔ Line, Staff relations
- ➔ Deligation of Authority

Structure

18.1 Introduction:

Almost any business manager will affirm that sound organisation is highly important to business success. Many will characterise organisation as the foundation upon which the whole structure of management is built. Organisation also refers to the structure of relationships among positions and jobs which is built up for the realisation of common objective. In this, the static sense of the term, organisation is the vehicle through which goals are sought to be attained.

18.2 Organisation:

Organisation is understood as a dynamic process and a managerial activity which is necessary for bringing people together and trying them together in the pursuit of common objectives.

18.2.1 Definition of Organisation:

Organisation is defined in many ways by different authors. Following are significant and popular definitions of organisations.

Accoring to Louis ***A.Allen***- “Organisation can be defined as the process of identifying and grouping the work to be performed, defining and delegating responsibility and authority and establishing relationships for the purpose of enabling people to work most effectively together in accomplishing objectives”.

Wheeler defined as “the internal organisation is the structural frame work of duties and responsibilities required of personnel in performing various functions within the company. It is essentially a blue print for action resulting in a mechanism for carrying out function to achieve the goals set up by company management”.

Koonty and O'Donnell defined as "The establishment of authority relationships with provision for co-ordination between them, both vertically and horizontally in the enterprise structure.

18.2.2 Features of Organisation:

Following are the common features of organisation.

1. Division of Labour: - The total work considered necessary for the realisation of common objectives is divided into activities and functions. Such division is essential because the work is too much for any single individual. In a Business organisation the work is divided according to functions like-

- ★ Production
- ★ Marketing
- ★ Finance &
- ★ Personnel etc.

2. Co-ordination: - The divided work for purposes of realising common goals, it becomes necessary to link up the various divisions, or activities so that all of them are unified and harmonised.
3. Accomplishment of Goals or Objectives: - An organisation structure is built up around certain clear cut goals or objectives because it is the ideal way of making a rational pursuit of objectives.
4. People: - An organisation is basically a group of persons. Therefore, activity groupings and authority provisions must take into account the limitations and customers of people.
5. Authority & Responsibility: - An organisation structure consists of various positions arranged in a hierarchy with a clear definition of the authority and responsibility associated with each of these.
6. Communication: - Every organisation has its own channels of communication. Such channels are necessary for mutual understanding and co-operation among the members of an organisation.
7. Environment: - The organisation structure must be designed to work efficiently in a changing environment.
8. Rules & Regulations: - Every organisation has some rules and regulations for orderly functioning of people.

18.3 Formal and Informal Organisations:

Organisation structures are two types they are-

1. Formal Organisation
2. Informal Organisation

18.3.1 Formal Organisation:

The position, authority, responsibility and accountability of each level are clearly defined in the case of a formal organisation. It prescribes the relationship which exist amongst the people working in the organisation. This relationship is defined by rules, policies and other regulations of the organisation very consciously to enable the people of the enterprise to work most effectively together in accomplishing their objectives.

The formal organisation is a more or less arbitary structure to which the individual must adjust. It tells him to do certain things in a specified manner, to obey orders from designated individuals, and to work co-operatively with others.

Definite limits for the activities of people are set by the formal organisation. Defined responsibilities and authority provide relatively fixed fences within which people can develop their own work areas to the maximum without encroaching on the work of others.

- **Features of Formal Organisation:**

1. Consciously brought into existence for pedetermined objectives.
2. Authority and responsibility are defined.
3. The line of communication is also formalised.
4. The relationship of the superior and the subordinates is fixed.
5. It exists in a written form, and facilitates the determination of objectives and policies according to division of work.

- **Advantages of Formal Organisation:**

1. Formal organisation sets a well defined frame of work and relationships.
2. It is a network of official authority responsibility and communications.
3. It coordinates activities of two or more persons.

- **Draw backs:**

1. It does take into account, but is not based on the personality of the individual.
2. It is based strictly on proper delegation of authority.
3. Once formal organisation is formed, it creates informal organisation which not only conditions the former but also vitalize the same.

18.3.2 Informal Organisation:

Informal Organisation arises from the social interaction of people in the organisation. The people cut across formal channels and communicate amongst each other. It is due to friendship, mutual regard, intimacy and closed contact formed with relationship. Thus the informal organisation has no place in the formal organisation chart. It is formed to meet personal needs of the group and acts as an agency of social control. Informal organisation is not established by managers formally but arises spontaneously and naturally. For instance the members of a group may start recognising a person as their leader because of his age. Seniority, job-knowledge, information personality strength or skill etc. Thus informal organisation is earned not delegated. It is all-pervasive and is found in every enterprise at all levels of the managerial hierarchy.

It is very difficult to find a completely formal or a completely informal organisation. The formal managers should try to make use of informal managers for the achievement of goals of the enterprise.

Features of Informal Organisations:

Informal organisations are characterised by the following features.

1. It develops spontaneously and is not established by formal managers.
2. It is based as informal authority attached to the person, and not the position. Informal authority is earned and not delegated. This authority under informal organisation largely flows upward or horizontally.
3. Informal organisation represents human tendency to cut across formal channels and communicate informally with other parts of the enterprise.
4. People in the informal organisation are influenced by leaders without any formal authority.
5. It is all -pervasive and exists in every enterprise.
6. Informal organisation is not always destructive though at time it can make the job of managing more difficult. Because of its powerful influence on productivity and job satisfaction, formal management will do well to derive benefit from the study of informal organisation.
7. Informal organisation cannot altogether be abolished. Informal organisation is not created at the will of the formal managers; not the latter can do away with all the social conventions and group norms.

■ **Merits of Informal Organisation:**

1. Informal organisation blend with formal systems to make a workable system for getting work done. Many requirements which cannot be met with formal organisation can be met better by informal relations.
2. An informal organisation lightens the workload of the formal manager. If the employee know that their manager has the support of the existing informal organisation, they are more likely to respond to his ideas, to be motivated to work efficiently.
3. A significant benefit of informal organisation is that it gives satisfaction and stability to work group. It is the means by which workers achieve a sense of belonging and security.
4. It is a useful channel of employee Communication. Management often depends on informal system to convey certain types of information.

5. Presence of informal organisation encourages a manager to plan and act more carefully than he would otherwise.

- **Draw backs of Informal Organisation:**

  Informal organisations create a major danger or difficulty which require careful attention on the part of management.

1. Resistance to Change: - With the persistence of certain culture, these develops a tendency to perpetuate the 'status quo' and oppose change.
2. Role Conflict: - What is good for the employee is not always good for his employer. Hence a role conflict occurs.
3. Rumour: - Communication leads to rumour. Rumour is a dangerous disease that sweeps through an organisation as fast as wild fire, and usually with as much damage.
4. Conformity: - Social control exerts strong pressures for conformity under formal organisation. But conformity is caused as much by informal organisation.

18.3.3 Differences between Formal and Informal Organisations:

The formal and informal groups differ considerably and the major differences can be analysed as follows.

18.3.4 Relationship between Formal and Informal Organisations:

Formal and Informal organisations are the parts of the total organisation and therefore, it can be said that they are two sides of the same coin. The following points shows the relationship between these two groups.

1. It is difficult to find a completely formal or a completely Informal organisation.
2. The managerial functions are performed in both-formal and informal organisations.
3. In fact many times the informal organisation can prove to be important mechanism of proper effective functioning of formal organisation.
4. The formal organisation may facilitate informal association in several ways such as people work close to each other.

18.4 Authority:

Authority is the basis of organisation. It is essential to discharge managerial functions. It is the authority that makes the management position real and vests him with power to order subordinates and secure necessary compliance. Authority is defined in many ways such as-

"Authority is a legitimate right to give orders and get these orders obeyed".

"Authority is the capacity of a superior to make decisions affecting the behaviour of subordinates. It is the right to take action and utilize organisational resources".

According to Henry Fayol- "The right to give orders and power to extract obedience".

Table - 1

Differences between Formal and Informal Organisations

S.NO.		FORMAL ORGANISATION	INFORMAL ORGANISATION
1.	Origin	A formal group is created by the action of management in order to overcome the shortcomings of organisation structure.	Informal groups are created because the members of the organisation are not fully satisfied by the pattern of relationship prescribed by the organisation.
2.	Authority Structure	In formal groups members derive authority through the formal source, that is through delegation and redelegation.	In an informal group, every member is equal and they derive authority from interpersonal relationship.
3.	Nature of Groups	Formal groups are stable and continue for longer time. Their membership is decided by the organisation and there is provision of substitution of members.	Informal groups are quite unstable. Scince they are created by the members based on their value systems, likings, dislikings, they may disappear because of the change of members or their working is changed.
4.	Behaviour of Members	Behaviour of members in a formal group is governed by formally prescribed rules and regulations.	In an informal group, the behaviour of members is governed by group norms, beliefs and values
5.	Communication Pattern	Communication in a front group takes place on the lines of formal prescription.	In the informal group, communication can go through any direction as there is no prescribed channel.
6.	Size of Group	Size of group is based on the criterion of efficiency. It can be quite large in size.	The size of informal group tends to be small so that there is proper interaction among members to maintain group cohensiveness.
7.	Abolition	Many formal groups are created for specific purpose and when the purpose is served the groups are abolished by the organistional action.	Informal groups are created by people in the organisation on their own. Therefore, they can not be abolished by management action though such groups may affect the organisational functions adversely.

18.4.1 Sources of Authority:

There are broadly three theories regarding source from which authority originates. They are:

1. The formal authority theory.
2. The acceptance of authority theory.
3. The competence theory.

1. Formal Authority Theory: - According to this theory, all authority originates in the formal structure of an organisation. The managers at each level of the organisation derive their authority turn the managers at the higher level. For instance, the foreman may derive his authority from the Assistent Production Manager.

2. Acceptance of Authority Theory: - According to this theory the authority of a manager is determined by the acceptance of it by the subordinates. There is always an implied understanding that the subordinate must agree to obey his superior.

3. Competence Theory of Authority: - According to this theory, the source of authority is the technical competence of the manager. The subordinates accept their superior's authority as he is competent, intelligent and has qualities of head and heart.

18.4.2 Features of Authority:

The essential features of authority are enumerated below-

1. Authority is the relationship between two individuals- one superior and the other subordinate.
2. Authority is the right to act.
3. Authority is the power to make decisions and seeing that they are carried out.
4. Authority is used to achieve organisational goals.
5. Authority can be legitimised by various organisational rules, regulations, procedures, practices etc. However, all these have to be framed within the context of external environment of the organisation.
6. Since it is exercised in organisational context, it is in terms of doing right things at right time so that organisational objectives are achieved.

18.4.3 Merits of Authority:

1. Only through authority managers can get things done by workers.
2. With out authority it is not possible to take decisions.
3. Every manager can perform his duties effectively with required authority.

18.4.4 Demerits of Authority:

1. Authority of any position in the organisation is not absolute. It is restricted by several internal and external factors.
2. The scope of authority decreases at successively lower levels.
3. The use of authority by a manager over his subordinates is restricted by biological limitations, physical limitations, physical limitations, legal and social constraints etc.,

18.4.5 Limitations of Authority:

It may be noted that authority has many limitations.

1. No manager enjoys unlimited authority.
2. The limits on authority may be express or implied, internal or external or may arise on account of social, political and economic factors.
3. The policies, procedures, programmes, rules of a firm may limit the executive authority.
4. The implied limitation on the authority of a manager may arise on account of technological and biological constraints such as physical or mental capacity.
5. Labour law, also limit the authority of the managerial personnel.

18.4.6 Types of Authority:

Authority is divided into the following types.

1. Traditional Authority: - Traditional authority rests on the belief of the sacredness of the social order. The father is a patriarchal society, the mother in a matriarchal society obtains their legitimacy through custom.
2. Charismatic Authority: - This authority rests on the magical qualities of individual leaders. Subordinates may obey superiors out of respect for their superior ability, character, reputation etc.
3. Rational-Legal Authority: - Traditional authority can evolve into rational-legal authority if rules and regulations are formally prescribed in an organisation. Superiors issue orders and subordinates obey them because this is the way the organisation is established.
4. External Authority: - This authority comes from sources outside the organisation. An organisation operates legitimately because of sanctions from Government. The police organisation operates legitimately because it is part of the Government.
5. Position Authority: - This authority is institutional and is based on the position enjoyed by a person in the organisation.
6. Functional Authority: - This authority is based on expertise. The expert is accepted because of his prowness. This authority, like positional authority, depends on the acceptance of subordinates.

18.5 Responsibility:

Responsibility is the duty to which a person is bound by reason of his status or task. Such responsibility implies compliance with directives of the person making the initial delegation.

According to M.E.Hurley, "Responsibility is the duty to which a person is bound by reason of his status or task. Such responsibility implies compliance with directives of the person making the initial delegation".

18.5.1 Features of Responsibility:

i) Responsibility flows upward. Always a subordinate is responsible to his superior.

ii) The person who accepts responsibility is accountable for his performance.

iii) Responsibility can not be delegated.

iv) Responsibility is a derivative of authority.

v) Responsibility originates from superior-subordinate relationship.

vi) Responsibility of a subordinate is in the nature of a continuing obligation. In some other cases, responsibility may result from a contractual agreement.

18.6 Authority - Responsibility:

Authority and Responsibility should always be commensurate and co-extensive with each other. Otherwise, the performance of managers goes unchecked. Where authority exceeds responsibility, a manager may get away with it. On the contrary, he may feel frustrated if responsibility exeeds authority. This is because he may be held responsible for more than his tasks. The authority delegated to him is not in proportion to the responsibility.

18.6.1 Differences between Authority and Responsibility:

Table - 2

S.No.	AUTHORITY	RESPONSIBILITY
1.	Authority flows downward.	Responsibility flows upward.
2.	Siperior has the Authority to assign and control the work of subordinate.	Subordinate is responsible to his superior.
3.	Authority is the right to act.	Responsibility is the obligation to carry out delegated authority.
4.	Authority can be delegated.	Responsibility can not to delegated.
5.	Authority is a continuing process.	Responsibility may be continuing obligation or contractual agreement.
6.	Authority is legitimised by certain rules, regulations, laws and practices.	Responsibility arises on the basis of superior subordinate relationship.

18.7 Power:

Power is one's ability to induce or influence the beliefs or actions of other persons or groups. If the term 'Power' is often considered as synonymous to authority. Power, like authority is a means of exercising influence on the behaviour of people. Power is stranger than influence. It is a personal force that enables a person to change the behaviours of others.

18.7.1 Types of Power:

Following five types of power can occur at all levels in an organisation.

a) Reward power: - It is the ability of a person (influencer) to reward another person (influencee) for carrying out given orders. Rewards constitute the best reinforcing factor to trigger the desired performance from the latter. The greater the attraction for the reward for the latter, the greater is his respect for the former.

b) Coercive power: - The negative side of a reward power is called coercive power. If an employer can punish his employee for not having complied with the orders, he is said to exercise coercive power. The punishment may range from a loss of a minor privilege to loss of job.

c) Legitimate power: - Every job or position in an organisation has defined rights, obligations and duties associated with it. A person occupying such position derives the powers to take decisions related to that job. A government official derives power from a popular government. Such type of power is also called as 'legitimate' power.

d) Expert power: - Experts such as doctors, judges and lecturers may influence others with their power of knowledge. The patients believe in the expertise of a doctor and follow his advice. Mahatma Gandhi did not have any legitimate power but the force of his vision and commitment to the cause of independence strongly influenced the behaviour of the people.

e) Referent power: - When an employee wishes to identify himself with the style of functioning of his employer, he is said to be under referent power. A charismatic member may mesmerise all other members in corporate board meetings and make them agree to his viewpoint. The higher his prestige and image, the larger the referent power on his audience.

18.7.2 Differences between Power and Authority:

Sometimes two terms 'Authority and Power' are used interchangeably because of their common objective of influencing the behaviour of people on whom these are exercised. However, there is difference between these two.

Table - 3
Differences between Power and Authority

S.No.	AUTHORITY	POWER
1.	Right to do something.	Ability to do something.
2.	Legitimate power given by an organisation to a holding position.	Requires no formal position to be recognised as power.
3.	Derived from organisation position only.	Derived from many sources.
4.	Narrow term, authority is one of the major sources of power.	Broad concept which created action when authority fails to achieve the results.
5.	Authority is legitimated by certain rules, and laws.	Power has no such legitimation

Failure to equate power and authority at all organisational levels may lead to disastrous consequences. Power without authority may be abused and authority without power may be totally meaningless. For organisational success, therefore, subordinates should have means (Power) equal to their Rights (Authority).

18.8 Forms of Organisation:

An organisation can be classified on the basis of authority relationships or on the basis of departments in it. The significant forms of organisation based on authority relationships are-

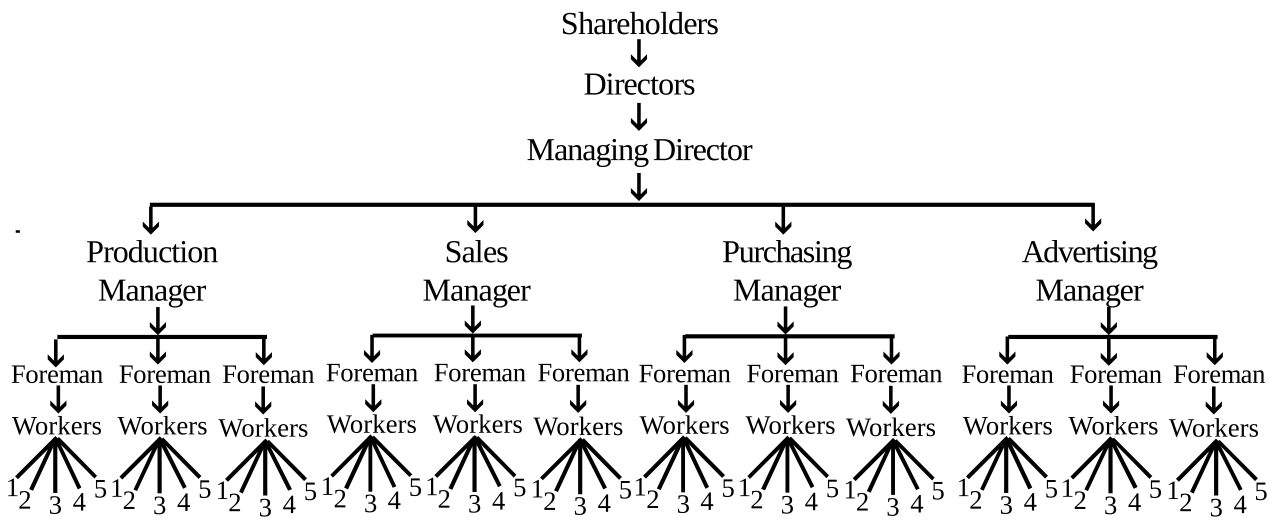
1. Line Organisation.
2. Line & Staff Organisation.
3. Functional Organisation.

18.8.1 Line Organisation:

Line organisation is also called military or scalar organisation. It is traditional type of organisation. In line organisation managers are directly responisble for results. The authority flows from top to the lower levels . This organisation is a vertical structure where one person delegates authority to his subordinate and who in turn delegates to his subordinate and so on. Authority flows in an unbroken straight line, it is called line organisation. This form of organisation is followed in military establishments. The commander-in-chief is at the top with various other officers at the lower levels.

The following figure gives an idea of line organisation.

Figure - 1
Line Organisation



■ **Features:**

Line organisation has the flowing characteristics:

1. Lines of authority are vertical. Following from top to the bottom.

2. The command is through a straight and unbroken line. Each subordinate receives orders from one superior and is responsible to him alone.

3. All persons at the same level are independent of each other.

4. The authority and responsibility of each position is clearly specified.

5. There are no staff specialists.

■ **Advantages:**

Line organisation has the following merits.

1. <u>Simplicity</u>: - It is easy to establish and operate. It is also simple to explain to the employees.

2. <u>Directness</u>: - Every member of the organisation knows to whom he is responsible and the exact function for which he is responsible.

3. <u>Fixed Responsibility</u>: - The responsibility is not divided. At each level employees and superiors are subject to singleness of control.

4. <u>Discipline</u>: - Singleness of responsibility and control ensures excellent discipline in the organisation. Men, especially at the lower levels of an organisation will be major loyal to one single authority than to multiple authorities.

5. Prompt decision: - The unification of authority and responsibility facilitates quick and prompt decisions.

6. Flexibility: - Singleness of responsibility and control ensures flexibility to suit the changing conditions.

7. Co-ordination: - As all activities relating to one department are managed by one person there is greater scope for effective co-ordination.

- **Disadvantages:**

The system suffers from the following defects.

1. Over loading: - Under this system, a few key executives are over-worked and this deprives the organisation of constructive development which is the result of reflective thinking.

2. Discourages large-scale co-operation: - As one executive controls the various activities of a department, undue importance is given to this executive without giving proper attention to his assistants. This results in inadequate co-operation in the organisation.

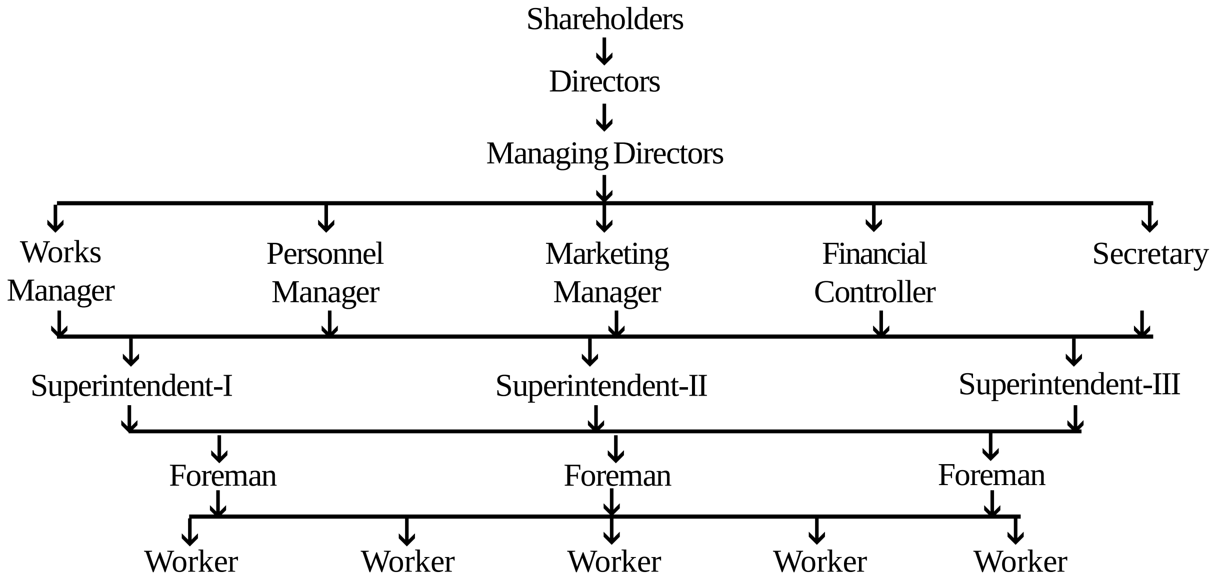
3. Lack of Specialisation: - The departmentation may be on the basis of related functions. Within a particular function, a high degree of specialisation is necessary. But under this system, specialisation is not possible.

4. Scope for favouritism: - Since only one person controls all the activities of a department, there is much scope for nepotism and favouritism.

18.8.2 Functional Type of Organisation or Staff Organisation:

Under the line type of organisation, there is a difficulty of getting men with sufficient capacity, training and adaptability. Taylor recognising this limitation, proposed a functional type of organisation. Taylor observed that one single foreman was over burdened with all the operations such as, task setting, time recording, quality inspection, disciplinary jobs etc. He divided this job into eight functional foreman-four with the planning task and four with the implementation task. As the name implies, the whole task of management and direction of subordinates should be divided according to the type of work involved. The functional management divides up management into a number of functions. Such as production, research and development, personnel, purchasing, finance, office management and sales. Each one of these departments would serve the rest of the organisation. For instance, the personnel department would recruit, train and deal with the people required for all the other departments. Following figure given an idea about functional organisation.

Figure - 2
Functional Organisation



- **Features:**

1. In functional organisation the task of management and direction of subordinates should be divided according to the type of work involved.

2. All the persons in the organisation dealing with a particular function are put under the charge of a person controlling that particular function.

3. Introduction of functional foremenship is another feature of functional organisation.

4. The specialist incharge of a functional department has the authority over all other employees for his function.

5. Specialists operate with considerable independence.

- **Advantages:**

1. It ensures a greater division of labour and enables the concern to take advantage of specialisation of functions.

2. It makes for a higher degree of efficiency as the workers and others in the organisation have to perform a limited number of operations.

3. It ensures the separation of mental and manual functions.

4. It facilitates mass production through specialisation and standardisation.

- **Disadvantages:**

under several different bosses.

1. It is too complicated in operation because it entails the division of functions into a number of sub-functions. This also leads to lack of co-ordination among the workers.

2. It makes difficult for the management to fix responsibility for unsatisfactory results.

3. It may also lead to conflict among foremen of equal work.

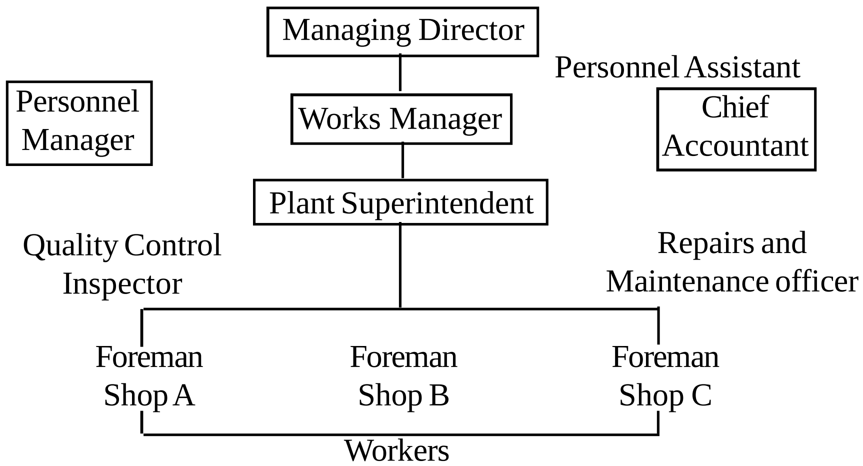
4. It is expensive.

18.8.3 Line and Staff Organisation:

Line and staff organisation is a combination of line and functional structures. Under it, line authority flows in a vertical line in the same manner as in the line organisation. In addition, staff specialists are attached to line positions to advise them on important matters. These specialists do not have power of command over subordinates in other departments. They are purely of advisory nature. When the work of line executives increases, they need advice, information and help of staff specialists. Therefore, staff positions are created to support the line managers.

Figure - 3

Line and Staff Organisation



- **Features:**

1. The line and staff system divides the work of the administration of business units into two broad divisons viz. staff for planning and staff for assisting.

2. It is based on the principle of specialisation.

3. It provides the expert advice to the line management.

4. All persons at the same level of authority are independent of one another.

Advantages:

Line and staff organisation offers the following advantages:

1. Expert advice: - Line managers recieve specialised advice and assistance from staff experts. They are enabled to discharge their responsibilities more efficiently.

2. Relief to top executives: - Staff carry out detailed investigation and supply information to line executives. Therefore, the burden of line executives is reduced. They get ample chance for creative thinking to generate new ideas.

3. Quality decisions: - Staff specialists provide adequate information and experts advice. As a result line executives can take better decisions.

4. Training of personnel: - As every executive concentrates in one field, he acquires valuable experience. Young staff executives get opportunity of acquiring expertise in their respective fields of activity. There are greater opportunities for advancement.

5. Flexibility: - Line and staff organisation is comparitively more flexible. As the organisation expands, staff can be added to help the line managers. There is more opportunity for advancement because a greater variety of responsible jobs is available. Stability of the enterprise does not depend on top executives alone.

Disadvantages:

Line and staff organisation suffers from the following drawbacks:

1. Line staff conflicts: - The main problem of line and staff organisation is that conflicts often arise between line managers and staff specialists.

2. Confusion: - In actual practice, it is often very difficult to define clearly the authority relationships between line and staff. Different managers may not be clear as to what is the actual area of operations and what is expected of them. In the absence of clear allocation of duties, co-ordination may be hampered.

3. Ineffective staff: - Staff personnel are not accountable for the results. Therefore, they may not take their tasks seriously. They may also be ineffective due to lack of command authority.

4. Expensive: - Line and staff organisation is quite expensive for small firms because several experts have to be employed.

Despite these limitations, line and staff organisation is very suitable for large organisations. It provides ample scope for specialisation without violating the unity of command. Its success depends upon the degree of harmony that is maintained among the line and staff. However, it may not be useful for small organisations which cannot take full advantage of staff experts.

18.8.4 Differences between Line Organisation and Functional Organisation:

Table - 4

LINE ORGANISATION	STAFF ORGANISATION
1. Right to decide and to command	1. Right to provide advice, assistance and information
2. Contributes directly to accomplishment of organisational objectives	2. Assists line in the effective accomplishment of organisational objectives
3. Relatively unlimited and general	3. Relatively restricted to a particular function
4. Flows downward from a superior to a subordinate	4. May flow in any direction depending upon the need of advice
5. Possessed by generalists	5. Possessed by specialists
6. Creates superior-subordinate relations	6. Extension of line and supports line
7. Exercises control	7. Investigates and reports
8. Makes operating decisions	8. Provides ideas for decisions
9. Bears final responsibility for results	9. Does not bear final responsibility
10. Doing function	10. Thinking function
11. Provides channel of communication	11. No channel of communication is created

18.8.5 Conflict between Line and Staff Organisation:

Line and staff relationship is based on the assumption that both support each other and work harmoniously to achieve organisational objectives. However, there are frequent instances of conflict between line and staff organisation. The various factors leading to line-staff conflict can be grouped into three categories: viewpoint of line, viewpoint of staff, and nature of line-staff relationship. Let us see how these factors generate conflict.

- **Viewpoint of Line Managers**

Line managers, who are responsible for the final results leading to the achievement of organisational objectives, feel that staff people work against them in the following ways.

1. Lack of Responsibility: - It is the perception of line managers that staff people do not carry any responsibility in the organisation, but enjoy authority. This lack of responsibility makes them complacement and they do not care about the ultimate objectives of the organisation.

2. Encroachment of Line Authority: - Line managers feel that staff people encroach upon their authority. They give recommendations and advice on the matters which fall within their jurisdication.

3. Dilution of Authority: - There is a feeling that staff people dilute line authority. In fact, staff authority emerges out of dilution of line authority. Line managers may fear that their responsibility will be reduced because of the addition of staff thereby making their job less challenging and varied.

4. Theoretical Bais: - Often the advice and recommendation of staff people suffer from theoretical bais because of two reasons. First, they tend to think within the context of their own speciality. Second, often staff people are away from the actual operational scene for which they make recommendation.

■ **Viewpoint of Staff Managers**

Like line managers, staff people have their own arguments and try to find faults with line managers which result into line-staff conflict. Their arguments and problems run on the following lines.

1. Lack of Proper Use of Staff: - Staff people feel that line managers do not make peoper use of staff people. Quite often staff people are ignored by line managers and decisions are made without inputs from staff. Staff people are informed after the action has been taken.

2. Resistance of New Ideas: - Line managers often resist new ideas because new ideas mean that there is something wrong with their present way of working. Thus new ideas are treated as fault-finding device in their operation and they resist the new ideas. As against this, staff people are more innovative in the area of their speciality. Because line people are reluctant to new ideas, many of the efforts of staff people go in waste.

3. Lack of Proper Authority: - Staff people feel that line managers do not give enough authority to them. They contribute to the realisation of organisational objectives without really enjoying any authority.

18.9 Deligation of Authority:

The process of transferring or assigning authority from the superior to the subordinate in an organisation is called delegation. It is an administrative process of getting things done by giving them responsibility. All important decisions are taken at top level by Board of Directors. The execution is entrusted to Chief executive. The chief executive assigns the work to departmental managers who in turn delegate the Authority to their subordinates. Every superior delegates the authority to subordinates for getting a particular work done.

■ **Definition:**

'Allen' defined the delegation of Authority as "The entrustment of a part of the work or responsibility and authority to another, and the creation of accountability for performance".

'O.S.Hiner' defined delegation as "Delegation takes place when one person gives another the right to perform work on his behalf and in his name, and the second person accepts a corresponding duty or obligation to do what is required of him".

'Louis' defined authority as "Delegation is the entrustment of authority and responsibility to another and the creation of accountability for performance.

- **Importance and Need of Delegation of Authority:**

Delegation is a universally accepted principle. It has been practised since time immemorial and in every field. Delegation is necessary not only for a business undertaking but also for running a government. An industrial undertaking benefits by delegation in the following ways:

1. Relieving Top Executives: - Top executives cannot perform and supervise each and every work. Moreover they are required to undertake important tasks of planning and controlling. Delegation helps executives in delegating their work to subordinate officers.

2. Improved Functioning: - In the absence of delegation some persons may be burdened with more tasks while others may not have sufficient work to do. Delegation helps in rationalising the functioning of an organisation. Work is divided among various persons in such a way that it is done in an efficient way. Nobody is unduly burdened and no work is left unattended.

3. Use of Specialists: - Delegation enables the use of specialists for taking up different functions. A production manager will be assigned the task of production, a sales manager will look after sales department, a Lawyer will look after legal matters and soon. The use of specialists for different functions will improve the quality of work.

4. Helps in Employee Development: - When subordinates are given independent assignments then they will be able to use their initiative and experience. This will also give them confidence in taking up further responsibilities. Without delegation, subordinates will not get a chance to try their knowledge. Delegation of power is the best way of developing subordinates and preparing them for taking up more responsibilities in future.

5. Helps in Expansion and Diversification: - The expansion and diversification of an enterprise needs the services of more and more persons. The assignment of various tasks to subordinates will prepare them for undertaking new assignments. If subordinates are not assigned important works earlier then it will be dangerous to give them independent tasks straight way. Delegation is very useful undertaking expansion and diversification plans.

18.9.1 Features of Delegation of Authority:

Delegation is the assignment of authority to subordinates in a defined area and making them responsible for the results. It has the following features.

1. Delegation takes place when a manager grants some of his powers to subordinates.
2. Delegation occurs only when the person delegating the authority himself has that authority i.e. a manager must possess what he wants to delegate.

3. Only a part of authority is delegated to subordinates.

4. A manager delegating authority can reduce, enhance or take it back. He exercises full control over the activities of the subordinates even after delegation.

5. It is only the authority which is delegated and not the responsibility. A manager cannot abdicate responsibility by delegating authority to subordinates.

18.9.2 Principles of Delegation:

Delegation of authority cannot be effective unless certain principles are followed in practice. While delegating authority, a manager should observe the following principles:

1. <u>Functional definition</u>: - Before delegating authority a manager should define clearly the functions to be performed by subordinates. The objectives of each job, the activities involved in it and its relationship with other jobs should be defined.

2. <u>Delegation by results expected</u>: - Authority should be delegated only after the results to be achieved by the subordinates are decided. This will enable them to know by what standards their performance will be judged.

3. <u>Parity of authority and responsibility</u>: - There must be a proper balance between authority and responsibility of a subordinate. Responsibility without authority will make a subordinate ineffective as he cannot discharge his duties. Similarly, authority without responsibility will make the subordinate irresponsible. Therefore, authority and responsibility should be co-extensive.

4. <u>Absoluteness of responsibility</u>: - Responsibility cannot be delegated. No manager can avoid his responsibility by delegating his authority to subordinates. After delegating authority he remains accountable for the activities of his subordinates. Similarly, the subordinates remain accountable to their superior for the performance of assigned duties.

5. <u>Unity of command</u>: - At one, time a subordinate should recieve command and be accountable to only one superior. If a person reports to two superiors for the same job, confusion and conflict will arise. He may receive conflicting orders and his loyalty will be divided. Therefore, dual subordination should be avoided.

6. <u>Well-defined limits of authority</u>: - The limits of authority of each subordinate should be clearly defined. This will avoid overlapping of authority and will allow the subordinate to exercise initiative. He will refer those matters to the superior which are outside the limits of his authority.

7. <u>Authority level principle</u>: - Managers at each level should make all decisions within their jurisdiction. They should avoid the temptation to refer to their superiors decisions which they are authorised to take themselves. Only matters outside the scope of authority should be reffered to superiors.

18.9.3 Advantages of Delegations:

Delegation is the essence of sound organisation. A single individual cannot manage and control everything due to physical and mental limitations. So he must divide his work load and share his responsibilities with others. Delegation of authority provides the following advantages.

i) It enables the managers to distribute their work load to others. By reducing the work load for routine matters, they can concentrate on more important policy matters.

ii) Delegation facilitates quick decisions.

iii) Delegation helps to improve the job satisfaction, motivation and morale of subordinates.

iv) It helps to satisfy subordinates needs for recognition, responsibility and freedom.

v) By clearly defining the authority and responsibility of subordinates, a manager can maintain healthy relationships with them.

vi) Delegation increases interaction and understanding among managers and subordinates.

vii) Delegation binds the formal organisation together. It establishes superior-subordinate relationships and provides a basis for efficient functioning of the organisation.

viii) Delegation enables a manager to obtain the specialised knowledge and expertise of subordinates.

ix) Delegation helps to ensure continuity in business because managers at lower levels are enabled to acquire valuable experience in decision-making.

x) It also facilitates the expansion and diversification of business through a team of competent and contented workers.

18.9.4 Obstacles to Delegation:

Even though delegation is vital for the efficient functioning of an organisation, in practice there are several factors which prevent effective delegation. These problems in delegation may be classified into three categories:

i) Superior,
ii) Subordinate, and
iii) Organisation

- **On the Part of Delegation (Non-delegation)**

Managers are often reluctant to delegate adequate authority due to the following reasons:

1. Some managers may not delegate authority because of their lure for authority. They are autocrats and think that delegation will lead to reduction of their influence in the organisation. They want to make their presence felt and desire that subordinates should come frequently for approval. They like to dominate the whole show.
2. Some managers feel that none can do the job as well as they can do. They think that if they delegate, work will not be done as it ought to be done. They consider themselves indispensable and do not want to give other people's ideas a chance.
3. When a manager is incompetent his work methods and procedures are llikely to be faulty. He keeps all the authority to himself for fear of being exposed. He is afraid that if he lets the subordinates make decisions they may outshine him. He is afraid of losing his importance.
4. Few managers are inclined to accept the risk of wrong decisions which the subordinates might take. Therefore, they do not delegate authority and take all the decisions themselves. They are unwilling to take calculated risk.
5. A manager may not delegate authority because he feels that his subordinates are not capable and reliable. He lacks confidence in his subordinates.
6. A manager is not likely to delegate authority when he cannot issue suitable directions to guide the activities of subordinates. Such lack of ability to direct shows that he is unfamiliar with the art of delegation.
7. Effective delegation requires adequate controls and a means of knowing the proper use of authority. A manager will hesitate to delegate authority if he has no means to ensure that the authority is being properly used by the subordinates.

■ **On the Part of Subordinates (Non-acceptance of Delegation)**

Subordinates may not like to accept delegation and shoulder responsibility due to the following reasons:

1. Subordinates may be reluctant to accept delegation when they lack self-confidence.
2. Some subordinates are unwilling to accept authority due to the desire to play safe by depending on the boss for all deccisions. They have a love for spoon-feeding..
3. A subordinate who is afraid of committing mistakes and does not like to be criticised by the boss is likely to avoid delegation of authority.
4. When the subordinates are already overburdened with duties, they do not like responsibility through delegation.
5. Subordinates are likely to avoid delegation when adequate information, working facilities and resources are not available for proper discharge of duties.
6. Subordinates may not come forward to accept delegation of authority when no incentives are available to them.

- **On the Part of the Organisation**

Sometimes superiors want to delegate authority and subordinates like to accept delegation. But delegation may be hampered due to weakness in the organisation structure. Some of these weaknesses are as follows:

1. Inadequate planning,
2. Splintered authority,
3. Lack of unity of command,
4. Absence of effective control techniques,
5. Non-availability of competent managers,
6. Unclear authority relationships, and
7. Environment of internal distruct.

In any organisation, the degree of delegation depends upon several factors, *e.g.,* size of the organisation, decentralised performance, management philosophy, availability of managers, work-load of managers, environmental influence, etc.

18.9.5 Making Delegation Effective (Guidelines for Effective Delegation)

Inadequate and ineffective delegation leads to several undesirable consequences, e.g., non-commitment, lack of initiative, frustration, inefficiency, etc. Therefore, it is necessary to make delegation effective. The following measures may be used for this purpose:

1. <u>Establishment of definite goals</u>: - Delegation is a means for efficient accomplishment of organisational objectives. Therefore, objectives must be clearly defined for meaningful delegation. Subordinates hesitate to accept delegation when they do not know clearly what is expected of them. Proper goal-setting focuses attention on what authority will be required to achieve the goals.

2. <u>Clear definition of authority</u>: - The authority and responsibility of each subordinate should be defined in clear terms. This helps to prevent overlapping of authority, avoids gaps in responsibility and avoids confusion. It enables a manager to know his limits of authority. The delegator must know what authority is to be delegated and within what limits.

3. <u>Proper motivation</u>: - Subordinates should be given positive incentives for accepting responsibility. A manager's feeling of insecurity should be avoided by providing proper status symbols. Managers having delegated authority should be suitably rewarded.

4. <u>Appropriate environment</u>: - A work climate free from fear and frustration should be created. Top management should provide adequate information and support and resources to subordinates for effective delegation.

5. <u>Proper training</u>: - Subordinates should be given adequate training for proper use of delegated authority. This will also help to develop their selfconfidence and morale. The manager shoould consider the abilities and limitations of the subordinates to whom authority is to be delegated.

6. Effective control mechanism: - Proper control techniques should be developed to ensure that authority is properly used by subordinates. However, control system should focus on major deviations from the standards and should not interfere in the day-to-day functioning of subordinates. The delegation of authority must be in accordance with the organisational set-up.

7. Proper communication: - There should be free and open lines of communication. This will enable the subordinates to get the help of the manager in discharging their duties. Sound communication will also enable the delegator to be in touch with his subordinates.

18.10 Summary:

Thus organisation is nothing but designing the roles. The formal organisation is a system of well defined jobs, each bearing a definite measure of authority, responsibility and accountability. The whole consciously designed to enable the people of the enterprise to work most effectively together in accomplishing their objectives. The informal organisation refers largely to what people do because they are human personalities- to their actions in terms of needs, emotions and attitudes not in terms of procedures and regulations. In the informal organisations people work together because of their personal likes and dislikes. Authority is the right to command, which emanates from organisational position. Whereas power is the capacity to command. Responsibility is the obligation on the part of a subordinate to complete the given job. The process of transfering or assigning authority from the superior to the subordinate in the organisation is called delegation. A formal organisation is always governed by organisational structure. An informal organisation is more governed by individual choice. It also strengthens the functioning of a formal organisations.

18.11 Terminology:

1. Division of labour : Splitting of work
2. Superior : Boss
3. Subordinate : Under staff
4. Delegation : Assign.

18.12 Self Assessment Questions:

- **Five Marks Questions:**

1. Define Organisation.

2. Authority - Responsibility.

3. Power

4. Functional Authority.

5. Delegation of Authority.

- **Ten Marks Questions:**

1. Explain features of Organisation.
2. Describe different types of Authority.
3. Explain differences between Authority and Power.
4. Describe differences between Authority and Responsibility.
5. Explain Meaning, Features, Merits and Demerits of Line Organisation.
6. Differences between Line system and Staff system.
7. Principles of Delegation of Authority.

- **Twenty Marks Questions:**

1. Discuss Formal and Informal Organisations.
2. What is Line-Staff relations? Explain Conflicts and Remedies of Line-Staff Organisations.
3. What is Delegation of Authority? Explain Problems and Remedies in the process of Delegation of Authority.

18.13 Books Recommended:

1. Industrial Organisation and Management.
   -A.R.Aryasri
   V.V.Ramana Murthy.
2. Principles and Practice of Management.
   -L.M.Prasad.
3. Management Theory & Practice.
   -C.B.Gupta.
4. Principles and Practice of Management
   -V.S.P.Prasad
   P.S.Narayana.

- Dr.K.Kanaka Durga