Text Book for

INTERMEDIATE

First Year

COMMERCE

Telugu and Sanskrit Akademi

Andhra Pradesh

Intermediate
First Year

Commerce
Text Book

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Y.S. JAGAN MOHAN REDDY

CHIEF MINISTER
ANDHRA PRADESH

AMARAVATI

MESSAGE

I congratulate Akademi for starting its activities with printing of textbooks from the academic year 2021 – 22.

Education is a real asset which cannot be stolen by anyone and it is the foundation on which children build their future. As the world has become a global village, children will have to compete with the world as they grow up. For this there is every need for good books and good education.

Our government has brought in many changes in the education system and more are to come. The government has been taking care to provide education to the poor and needy through various measures, like developing infrastructure, upgrading the skills of teachers, providing incentives to the children and parents to pursue education. Nutritious mid-day meal and converting Anganwadis into pre-primary schools with English as medium of instruction are the steps taken to initiate children into education from a young age. Besides introducing CBSE syllabus and Telugu as a compulsory subject, the government has taken up numerous innovative programmes.

The revival of the Akademi also took place during the tenure of our government as it was neglected after the State was bifurcated. The Akademi, which was started on August 6, 1968 in the undivided state of Andhra Pradesh, was printing text books, works of popular writers and books for competitive exams and personality development.

Our government has decided to make available all kinds of books required for students and employees through Akademi, with headquarters at Tirupati.

I extend my best wishes to the Akademi and hope it will regain its past glory.

(Y.S. JAGAN MOHAN REDDY)

Dr. NANDAMURI LAKSHMIPARVATHI
M.A., M.Phil., Ph.D.
Chairperson, (Cabinet Minister Rank)
Telugu and Sanskrit Akademi, A.P.

Message of Chairperson, Telugu and Sanskrit Akademi, A.P.

In accordance with the syllabus developed by the Board of Intermediate, State Council for Higher Education, SCERT etc., we design high quality Text books by recruiting efficient Professors, department heads and faculty members from various Universities and Colleges as writers and editors. We are taking steps to print the required number of these books in a timely manner and distribute through the Akademi's Regional Centers present across the Andhra Pradesh.

In addition to text books, we strive to keep monographs, dictionaries, dialect texts, question banks, contact texts, popular texts, essays, linguistics texts, school level dictionaries, glossaries, etc., updated and printed and made available to students from time to time.

For competitive examinations conducted by the Andhra Pradesh Public Service Commission and for Entrance examinations conducted by various Universities, the contents of the Akademi publications are taken as standard. So, I want all the students and Employees to make use of Akademi books of high standards for their golden future.

Congratulations and best wishes to all of you.

N. Lakshmiparvathi

(NANDAMURI LAKSHMIPARVATHI)

J. SYAMALA RAO, I.A.S.,
Principal Secretary to Government

Higher Education Department
Government of Andhra Pradesh

MESSAGE

I Congratulate Telugu and Sanskrit Akademi for taking up the initiative of printing and distributing textbooks in both Telugu and English media within a short span of establishing Telugu and Sanskrit Akademi.

Number of students of Andhra Pradesh are competing of National Level for admissions into Medicine and Engineering courses. In order to help these students Telugu and Sanskrit Akademi consultation with NCERT redesigned their Textbooks to suit the requirement of National Level Examinations in a lucid language.

As the content in Telugu and Sanskrit Akademi books is highly informative and authentic, printed in multi-color on high quality paper and will be made available to the students in a time bound manner. I hope all the students in Andhra Pradesh will utilize the Akademi textbooks for better understanding of the subjects to compete of state and national levels.

(J. SYAMALA RAO)

THE CONSTITUTION OF INDIA

PREAMBLE

WE, THE PEOPLE OF INDIA, having solemnly resolved to constitute India into a SOVEREIGN SOCIALIST SECULAR DEMOCRATIC REPUBLIC and to secure to all its citizens:

JUSTICE, social, economic and political;

LIBERTY of thought, expression, belief, faith and worship;

EQUALITY of status and of opportunity; and to promote among them all

FRATERNITY assuring the dignity of the individual and the unity and integrity of the Nation;

IN OUR CONSTITUENT ASSEMBLY this twenty-sixth day of November, 1949 do HEREBY ADOPT, ENACT AND GIVE TO OURSELVES THIS CONSTITUTION.

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Foreword

The Government of India vowed to remove the educational disparities and adopt a common core curriculum across the country especially at the Intermediate level. Ever since the Government of Andhra Pradesh and the Board ofIntermediate Education (BIE) swung into action with the task of evolving a revised syllabus in all the Science subjects on par with that of COBSE, approved by NCERT, its chief intention being enabling the students from Andhra Pradesh to prepare for the National Level Common Entrance tests like NEET, ISEET etc., for admission into Institutions of professional courses in our Country.

For the first time BIEAP has decided to prepare the Science textbooks. Accordingly an Academic Review Committee was constituted with the Commissioner ofIntermediate Education,AP as Chairman and the Secretary, BIEAP; the Director SCERT and the Director TeluguAcademy as members. The National and State Level Educational luminaries were involved in the textbook preparation, who did it with meticulous care. The textbooks are printed on the lines ofNCERT maintaining National Level Standards.

The Education Depm tment ofGovemment ofAndhra Pradesh has taken a decision to publish and to supply all the text books with free of cost for the students of all Government and Aided Junior Colleges of newly formed state of Andhra Pradesh.

We express our sincere gratitude to the Director, NCERT for according permission to adopt its syllabi and curriculum of Science textbooks. We have been permitted to make use of their textbooks which will be of great advantage to our student community. I also express my gratitude to the Chairman, BIE and the honorable Minister for HRD and Vice Chair man, BIE and Secretary (SE) for their dedicated sincere guidance and help.

I sincerely hope that the assorted methods of innovation that are adopted in the preparation of these textbooks will be of great help and guidance to the students. I wholeheartedly appreciate the sincere endeavors of the Textbook Development Committee which has accomplished this noble task.

Constructive suggestions are solicited for the improvement ofthis textbook from the students, teachers and general public in the subjects concerned so that next edition will be revised duly incorporating these suggestions. It is very much commendable that Intermediate text books are being printed for thefirst time by the Telugu Akademi from the 2021-22 academic year.

Sri. V Ramakrishna, I.R.S
Director, Telugu Akademi
Andhra Pradesh

Preface

We are happy to present this revised book “Elements of Commerce”, to beloved students and teacher friends. This book is written in a simple and lucid style for a better understanding of the subject. The growing popularity for the study of Commerce in all parts of the country is indicative of the recognition of the need for young men want vast to enter business in different capacities after a systematic study. In this book, a number of charts and diagrams are given for the benefit of the students who opt for self-study and further studies.

Commerce is an academic discipline that involves all topics of sole proprietorship, partnership and joint stock companies. There are twleve chapters in this book which are mainly devided into five units. The first unit deals with introduction to business and social responsibility of business. The second unit describes the forms of business organisation namely Sole trading, Partnership and Joint Hindu Family firm. The third unit discusses the Formation of a Company. The fourth unit explains about Business Finance and Sources of Business Finance. The fifth unit focuses on the Emerging Trends in Business and also highlights the opportunities and challenges of business in 21st Century.

The constructive criticism and valuable suggestions are inivited for further improvement of this book

- Editors

Preface to Revised Edition

The term business organisation refer to how businesses are structured and how that structure aids them in meeting their objectives. In general, businesses are created with an objective of making a profit or improving society. The commerce is a fast growing area as it allows for industries to develop, provide employment to unemployed, removes regional imbalance and paves the way for economic development of a nation. Hence, the students who opt 'Commerce' subject should have the updated knowledge of different forms of business organisations, sources of busiess finance to establish their own entities, MSMEs, MNCs and emerging trends in business. This helps the people to seek their own employment and become self reliant.

The government of Andhra Pradesh has rightly introduced new areas of business in its course at plus two level. The Telugu and Sanskrit Akademi also took initiative to review and revise the book 'Commerce' for the first year students of Intermediate. Hence, an attempt is made to revise the book thoroughly keeping in view the new Companies Act 2013, MSMEs Act, and emerging trends in business like e-business. With this background the present book is revised to suit the present day needs of the society. Inspite of our best efforts in preparing this book, some deficiencies may crept in. We welcome the constructive criticisms, suggestions and opinions from the academic fraternity to incorporate them in the next edition. we are highly thankful to Director, Telugu Akademi, Dr. Koteswaramma and the team of dedicated staff for the co-operation received in revising this valuable textbook.

Prof. Rudra Saibaba
Editor,
Review Edition

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Concept of Business

CHAPTER
1

1.1 Introduction to Business

The term Business refers to “the state of being busy”. Every individual is engaged in some activities to fulfill his/her set of needs and wants. All these activities are intended to satisfy human needs. For eg. a labourer works in the factory to earn wages and thereby satisfies his needs. Similarly, a farmer engages himself in agricultural activities and an employee works in the office, a teacher teaches in the classroom etc., to satisfy his needs, comforts and luxuries.

All the activities of human beings can be broadly classified into two. They are:

1. Economic Activities
2. Non-economic Activities

Economic Activities are the activities a man is engaged in, to earn his livelihood by producing and distributing goodsand rendering services.

Non economic activities are those activities that do not result in a payment. In otherwords the intention of these activities is not to earn money. For e.g., a mother preparing food, serving a child and a housewife rendering domestic services and doing household works are non-economic activities because they are not intended to earning money.

1.2 Classification of Economic Activities

Economic activities are broadly classified into three. They are

1. Profession
2. Employment, and
3. Business

1. Profession

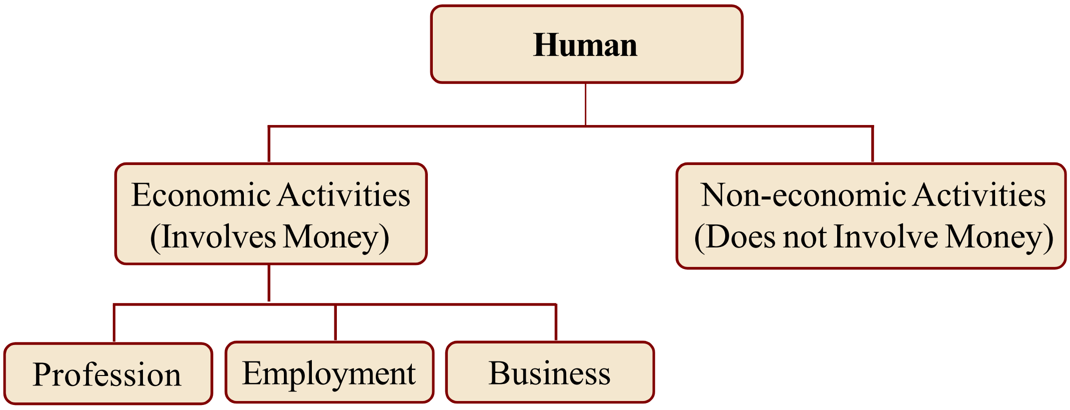
Profession is an occupation requiring specialized education. In other sense, profession refers "to a body of people in a learned occupation." It requires an association with a profesional body for a person to practise. For example, a Chartered Accountant needs to be a member of the Institute of Chartered Accountants of India (ICAI). A professional renders services of expert nature to his clients for a consulting fee. For e.g., a lawyer is engaged in legal advisory and consulting services for a fee. Similarly, a doctor treats the patients and a Chartered Accountant renders various services to his clients like auditing, tax planning, financial planning etc., for which he gets paid.

2. Employment

An employment is a contract of service. A person who works under the contract for a salary is called an employee and the person who has given the job to the employee is called employer. An employee works under an agreement as per the rules of service and performs tasks assigned to him by the employer. The relationship between the employer and the employee is that of a 'Master' and 'servant'.

3. Business

Business is an economic activity involving production, exchange, distribution and sale of goods and services with an objective of making profits.



Business - Meaning and Definitions

1. Etymologically business referts to the state of being busy.
2. The term business is interpreted as one's regular occupation or profession.
3. It refers to a particular entity, company or a corporation. e.g. SBI, Infosys.
4. It also refers to a particular market sector such as Automobile business, banking business etc.
5. Business refers to the activities of purchase, sale, manufacture, processing and marketing of goods and services.
6. Finally, the primary intention of business is making profits.

The following are some of the definitions of Business

L.H. Haney defined business as "a human activity directed towards producing or acquiring wealth through buying and selling of goods".

B.O. Wheeler "Business is an institution organized and operated to provide goods and services to society under the incentive of private gain".

Keith and Carlo "Business is a sum of all activities involved in the production and distribution of goods and services for private profits".

After careful analysis of the above definitions, business may be defined as an economic activity which involves regular transfer or exchange of goods or services for a price with an objective of earning profits and acquiring wealth through the satisfaction of human wants. Business creates utilities by producing and selling goods and services to satisfy human wants. Time, place and possession of values are created by business enterprises.

1.3 Characteristics of Business

The features of business are given below:

1. Creation of Utilities

Business makes goods more useful to satisfy human wants. It adds time, place, form and possession utilities to various types of goods. Business enables people to satisfy their wants more effectively and economically. It carries goods from place of production to the place of consumption (place utility). It makes goods available for use in future through storage (time utility).

2. Deals with Goods and Services

Every business enterprise produces or buys goods and services for selling them to others for a profit. Goods may be consumer goods or producer goods. Services are known as intangible and invisible goods.

- Consumer goods are meant for direct use by the ultimate consumers, e.g., bread, tea, shoes, etc.
- Producer goods are used for the production of consumer or capital goods like raw materials, machinery, etc.

Services like transport, warehousing, banking, insurance, etc., may be considered as intangible and invisible goods. Services facilitate buying and selling of goods by overcoming various hindrances in trade.

3. Continuity in Dealings

Dealings in goods and services become business only if undertaken on a regular basis. A single isolated transaction of purchase and sale does not constitute business. Recurring or repeated transactions of purchase and sale constitutes business." For instance, if a person sells his old scooter or a car it is not business though the seller gets money in exchange. But if he opens a shop and sells scooters or cars regularly, it will become business. Therefore, **regularity of dealings is an essential feature of business**.

4. Sale, Transfer or Exchange

All business activities involve transfer or exchange of goods and services for some consideration. The consideration, called price, is usually expressed in terms of money. Business delivers goods and services to those who need them and are able and willing to pay for them. For example, if a person cooks and serves food to his family, it is not business. But when he cooks food and sells it to others for a price, it becomes business.

5. Profit Motive

The primary objective of business is to earn profits. Profits are essential for the survival as well as growth of business. Profits must, however, be earned through legal and fair means. Business should never exploit society to make money.

6. Risk and Uncertainity

Profit is the reward for assuming risk. Risk implies uncertainty of profit or the possibility of loss. Risk is a part and parcel of business. Business enterprises function in uncertain and uncontrollable environment.

Changes in customers' tastes and fashions, demand, competition, Government policies, etc., create risk. Flood, fire, earthquake, strike by employees, theft, etc., also cause loss. A businessman can reduce risks through correct forecasting and insurance. But all risks cannot be eliminated.

7. Economic Activity

Business is primarily an economic activity as it involves production and distribution of goods and services for earning money. However, business is also a social institution because it helps to improve the living standards of people through effective utilisation of scarce resources of the society.

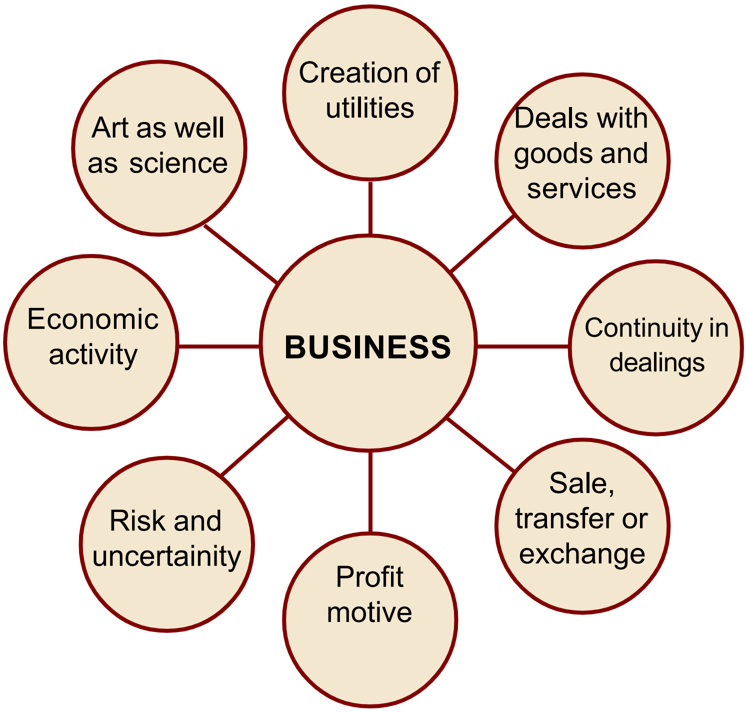
Only economic activities are included in business. Non-economic activities do not form part of business.

8. Art as Well as Science

Business is an art because it requires personal skills and experience. It is also a science because it is based on certain principles and laws.

The above mentioned characteristics are common to all business enterprises irrespective of their nature, size and form of ownership.

The following figure clearly depicts the characteristics of business



1.4 Objectives of Business

Every business enterprise has certain objectives. Objectives of business are classified into four broad categories viz., Economic objectives, Social objectives, Human objectives and National objectives.

1. Economic Objectives

Business is basically an economic activity. Therefore, its primary objectives are economic in nature. The main economic objectives of business are as follows:

i. Earning Profits

A business enterprise is established for earning some income. It is the hope of earning profits that inspires people to start business. Profit is essential for the survival of every business unit. Just as a person cannot live without food, a business firm cannot survive without profit. Profits enable a businessman to stay in business by maintaining intact the wealth producing capacity of its resources.

Profit is also necessary for the expansion and growth of business. Profits ensure continuous flow of capital for the modernisation and extension of business operations in future. Profit also serves as the barometer of stability, efficiency and progress of a business enterprise.

ii. Creating Customers

Profits arise from the businessman's efforts to satisfy the needs and wants of customers. A businessman can earn profits only when there are enough customers to buy and pay for his goods and services.

In the words of Peter F. Drucker, "There is only one valid definition of business purpose; to create a customer. The customer is the foundation of business and keeps it in existence. No business can succeed without providing customers value for their money. Business exists to satisfy the wants, tastes and preferences of customers.

In order to earn profit, business must supply better quality goods and services at reasonable prices. Therefore, creation and satisfaction of customers is an important economic objective of business.

iii. Innovation

Innovation refers to "creation of new things resulting from the study and experimentation, research and development". In these days of competition, a business can be successful only when it creates new designs, better machines, improved techniques, new varieties etc. Modern science and technology have created a great scope for innovation in the business world.

Innovation is not confined to the invention of a new machine. It comprises all efforts made in perfecting the product, minimising the costs and maximizing benefits to customers. Business firms invest money, time and efforts in Research and Development (R&D) to introduce innovation.

2. Social Objectives

Business does not exist in a vacuum. It is a part of society. It cannot survive and grow without the support of society. Business must, therefore, discharge social responsibilities in addition to earning profits.

According to Henry Ford, "the primary aim of business should be service and subsidiary aim should be earning of profit." The socials objectives of business are as follows:

(i) Supplying Desired Goods at Reasonable Prices

Business is expected to supply the goods and services required by the society. Goods and services should be of good quality and these should be supplied at reasonable prices. It is also the social obligation of business to avoid malpractices like smuggling, black marketing and misleading advertising.

(ii) Fair Remuneration to Employees

Employees must be given fair compensation for their work. In addition to wages and salary a reasonable part of profits should be distributed among employees by way of bonus. Such sharing of profits will help to increase the motivation and efficiency of employees.

It is the obligation of business to provide healthy and safe work environment for employees. Employees work day and night to ensure smooth functioning of business. It is, therefore, the duty of employers to provide hygienic working and living conditions for workers.

(iii) Employment Generation

Business should provide opportunities for gainful employment to members of the society. In a country like India unemployment has become a serious problem and no government can offer jobs to all. Therefore, provision of adequate and full employment opportunities is a significant service to society.

(iv) Social Welfare

Business should provide support to social, cultural and religious organisations. Business enterprises can build schools, colleges, libraries, dharamshalas, hospitals, sports bodies and research institutions. They can help non-government organisations (NGOs) like CRY (Child Relief and You), Help Age, and others which render services to weaker sections of society.

(v) Payment of Government Dues

Every business enterprise should pay tax dues (income tax, sales tax, excise duty, customs duty etc.) to the government honestly and at the right time. These direct and indirect taxes provide revenue to the Government for spending on public welfare. Business should also comply with the laws of the country. Thus, businessmen should pursue those policies and take those actions which are desirable in terms of the objectives and values of our society.

3. Human Objectives

Business is run by people and for people. Labour is a valuable human element in business. Human objectives of business are concerned with the wellbeing of labour which are given below:

i. Labour Welfare

Business must recognise the dignity of labour and human factor should be given due recognition. Adequate provisions should be made for their health, safety and social security.

ii. Developing Human Resources

Employees must be provided with the opportunities for developing new skills and attitudes. This can be done by training the employees and conducting workshops on skill development and attitude. Human resources are the most valuable asset of business and their development will help in the growth of business.

Business can facilitate self- development of workers by encouraging creativity and innovation among them. Development of skilled manpower is necessary for the economic development of the country.

iii. Participative Management

Employees should be allowed to take part in decision making process of business. This will help in the development of employees. Workers' participation in management will lead to industrial democracy.

iv. Labour-Management Cooperation

Business should strive for creating and maintaining cordial employer-employee relations so as to ensure peace and progress in industry.

4. National Objectives

National objectives of business are as follows:

(i) Optimum Utilisation of Resources

Business should use the nation's resources in the best possible manner. Judicious allocation and optimum utilisation of scarce resources is essential for rapid and balanced economic growth of the country. Wastage of scarce resources is a loss not only to the business but also to the nation.

Business should produce goods in accordance with national priorities and interests. It should minimise the wastage of scarce natural resources.

(ii) National Self-reliance

It is the duty of business to help the government in increasing exports and in reducing dependence on imports. This will help a country to achieve economic independence.

(iii) Development of Small Scale Industries

Big business firms are expected to encourage growth of small scale industries which are necessary for generating employment. Small scale firms can be developed as ancillaries which provide inputs to large scale industries.

(iv) Development of Backward Areas

Business is expected to give preference to the industrialisation of backward regions of the country. Balanced regional development is necessary for peace and progress in the country. It will also help to raise standard of living in backward areas. Government offers special incentives to the businessmen who set up factories in notified backward areas.

1.5 Social Responsibility of Business

Meaning

Business organisations are obliged to consider social impact of their decisions. The obligation of any business to protect and serve public interest is known as social responsibility of business. Any responsibility business has, particularly towards members of the society with whom they interact or towards the society in general called is social responsibility.

Need for Social Responsibility of Business

Every business operates within a society. It uses the resources of the society and depends on the society for its functioning. This creates an obligation on the part of business to look after the welfare of society. Therefore, all the activities of the business should be such that they will not harm, rather they will protect and contribute to the interests of the society. Social responsibility of business refers to all such duties and obligations of business directed towards the welfare of society.

The Concept of Social Responsibility

We all know that people engage in business to earn profit. However, profit making is not the sole function of business. It performs a number of social functions, as it is a part of the society. It takes care of those who are instrumental in securing its existence and survival like- the owners, investors, employees, consumers and government in particular and the society and community in general. So, every business must contribute in some way or the other for their benefit. For example, every business must ensure a satisfactory rate of return to investors, provide good salary, security and proper working conditions to its employees, make available quality products at reasonable price to its consumers, maintain the environment properly etc.

However, while doing so two things need to be noted to view it as social responsibility of business.

1) First, any such activity is not charity. It means that if any business donates some amount of money to any hospital or temple or school, college etc., it is not to be considered as discharge of social responsibility because charity does not imply fulfilling responsibility.

2) Secondly, any such activity should not be such that it is good for somebody and bad for others. Suppose a businessman makes a lot of money by smuggling or by cheating customers, and then runs a hospital to treat poor patients at low prices his actions cannot be socially justified.

Social responsibility implies that a businessman should not do anything harmful to the society in course of his business activities.

Thus, the concept of social responsibility discourages businessmen from adopting unfair means like black marketing, smuggling, adulteration, tax evasion and cheating customers etc., to earn profit. Instead, it encourages them to earn profit through judicious management of the business, by providing better working and living conditions to its employees, providing better products, after sales-service, etc., to its customers and simultaneously to control pollution and conserve natural resources.

Responsibility Towards Different Interest Groups

The business generally interacts with owners, investors, employees, suppliers, customers, competitors, government and society. They are called as interest groups because by each and every activity of business, the interest of these groups is affected directly or indirectly. Various responsibilities that a business has towards different groups with whom it interacts are as follows :

i. Responsibility Towards Owners

Owners are the persons who own the business. They contribute capital and bear the business risks. The primary responsibilities of business towards its owners are to:

a. Run the business efficiently.
b. Proper utilisation of capital and other resources.
c. Growth and appreciation of capital.
d. Regular and fair return on capital invested by way of dividends.

ii. Responsibility Towards Employees

Business needs employees or workers to work for it. These employees put their best effort for the benefit of the business. So it is the prime responsibility of every business to take care of the interest of their employees. If the employees are satisfied and efficient, then the only business can be successful. The responsibilities of business towards its employees include:

a. Timely and regular payment of wages and salaries.
b. Proper working conditions and welfare amenities.
c. Opportunity for better career prospects.
d. Job security as well as social security like facilities of provident fund, group insurance, pension, retirement benefits, etc.

iii. Responsibility Towards Suppliers

Suppliers are businessmen who supply raw materials and other items required by manufacturers and traders. Certain suppliers, called distributors, supply finished products to the consumers. The responsibilities of business towards these suppliers are:

a. Giving qualitative goods at reasonable prices.
b. Dealing on fair terms and conditions.

c. Availing reasonable credit period.

d. Timely payment of dues.

iv. Responsibility Towards Customers

No business can survive without customers. As a part of the responsibility of business towards them the business should provide the following facilities:

a. Products and services must be qualitative

b. Delivery of goods within stipulated time

c. Sell goods at reasonable price

d. There must be proper after-sales service.

e. Complaints and Grievances of the consumers, if any, must be settled quickly.

f. Unfair means like under weighing the product, adulteration, etc., must be avoided.

v. Responsibility Towards Government

Business activities are governed by the rules and regulations framed by the government. The various responsibilities of business towards government are:

a. Setting up units as per guidelines of the Government

b. Payment of fees, duties and taxes regularly as well as honestly.

c. Conforming to pollution control norms set up by government.

d. Not to indulge in corruption through bribing and other unlawful activities.

vi. Responsibility Towards Society

A society consists of individuals, groups, organizations, families etc. They all are the members of the society. They interact with each other and are also dependent on each other in almost all activities. There exists a relationship among them, which may be direct or indirect. Business, being a part of the society, also maintains its relationship with all other members of the society. Thus, it has certain responsibilities towards society, which may be as follows:

a. Help the weaker and backward sections of the society

b. Preserve and promote social and cultural values

c. Generate employment

d. Protect the environment

e. Conserve natural resources and wildlife

f. Promote sports and culture

Summary

Business is an economic activity which involves regular transfer or exchnge of goods and services for a profit and acquiring wealth through satisfaction of human needs and wants. Business creates utilities by producing and selling goods and services to satisfy human wants. Time, place and possession of values are created by business enterprises. Every business enterprise has economic, social, human and national objectives. The obligation of any business enterprise is to protect and serve the public interest as they operate within a society. More specially, the business organisations must be responsible to different interest groups like owners, employees, suppliers, customers, government and the society at large.

Questions

I. Essay Type Questions

1. Define Business. What are its characteristics?
2. Explain the objectives of a business.
3. Discuss the social responsibility of business.
4. Classify and describe each type of Economic activities.

II. Short Answer Type Questions

1. What are the Business objectives.
2. What are the Social objectives.
3. What is the role of profit in business.
4. Give a brief explanation of economic activities.
5. Is Business an Art and Science?

III. Very Short Answer Type Questions

1. Business
2. Profession
3. Employment
4. Innovation
5. Participative Management
6. Social Responsibility of Business

Student Activity

Students are advised to visit any small scale factory, which purchases raw materials, produces goods and markets the same goods.

Business Activities

CHAPTER

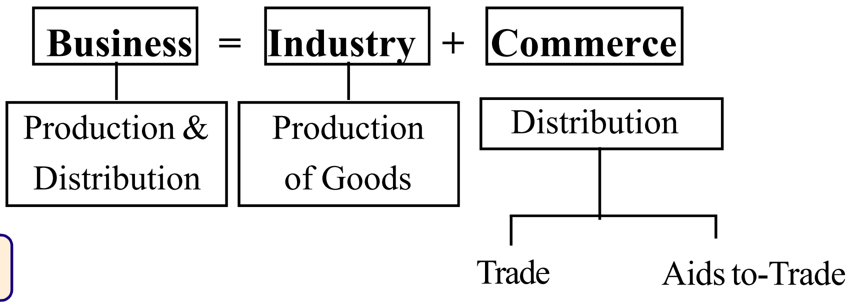
2

2.0 Classification of of Business Activity

Business activities may broadly be classified into two. They are;

1. Industry

2. Commerce



2.1 Industry

Meaning of Industry

The production side of business activity is referred to as industry. It is a business activity, which is related to the extracting, producing, processing or manufacturing of goods.

The goods may be consumer goods or producer goods. Consumer goods are the goods, which are used finally by consumers. e.g. food grains, textiles, cosmetics, VCR etc. Producer's goods are the goods used by manufacturers for producing some other goods. e.g., machinery, tools, equipment, etc.

Classification/ Types of Industry

There are various types of industries. They are described hereunder;

1. **Primary Industry**

   Primary industry is concerned with production of goods with the help of nature. It is a nature-oriented industry, which requires very little human effort. e.g. Agriculture, Farming, Forestry, Fishing, Horticulture etc.

2. **Genetic Industry**

   Genetic industries are engaged, in re-production and multiplication of certain species of plants and animals with the object of sale. The main aim is to earn profit from such sale. e.g., Plant nurseries, Poultry, Cattle breeding, etc.

3. **Extractive Industry**

   Extractive industry is concerned with extraction or drawing out goods from the soil, air or water. Generally products of extractive industries come in raw form and they are used by manufacturing and construction industries for producing finished products. e.g., Mining, Coal, Mineral, Oil, Iron ore, extraction of timber and rubber from forests, etc.

4. **Manufacturing Industry**

   Manufacturing industries are engaged in transforming raw materials into finished product with the help of machines and manpower. The finished goods can be either consumer goods or producer goods. e.g., Textiles, Chemicals, Sugar, Paper, etc. The manufacturing may be analytical, synthetic, processing and assembling industries.

   a. **Analytical:**In an analytical industry the basic raw material is broken into several useful materials. For example, in an oil refinery, crude oil is refined and several petroleum products are obtained.

   b. **Synthetic:** In this type of manufacturing industry two or more materials are mixed to form a new product. For example, Cosmetics, Soap, Fertilizers, Paint industry etc.

   c. **Processing:** In the processing industry, material is processed through various stages. For example, in the textile industry, cotton passes through the spinning, weaving, dyeing, bleaching and printing processes.

d. **Assembling:** In this type of industry, manufactured components or parts are combined together mechanically or chemically to produce a new product. Manufacture of T.V sets, watches and automobiles are the examples of assembling industries.

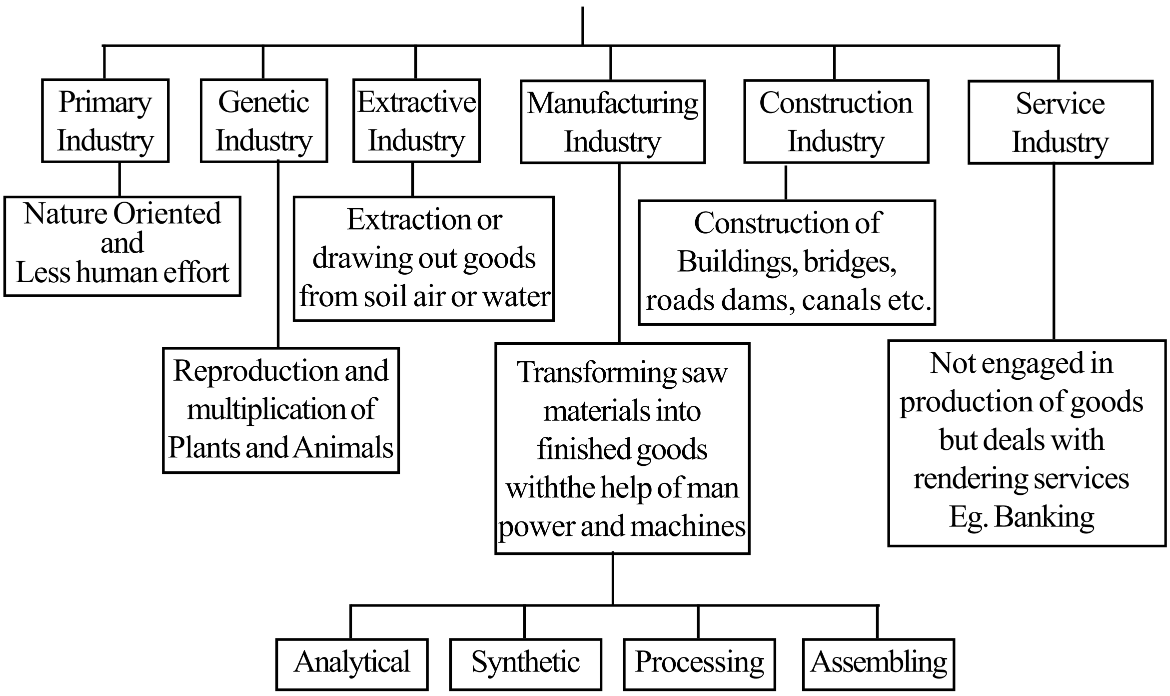
5. Construction Industry

Construction industries take up the work of construction of buildings, bridges, roads, dams, canals, etc. This industry is different from all other types of industries. The other industries can be produce goods at one place and sold them at another place. But goods produced and sold by constructive industry are erected at one place.

6. Service Industry

In modern times, service sector plays an important role in the development of the nation and therefore it is named as service industry. The main industries, which fall under this category include Hotel industry, Tourism industry, Entertainment industry, etc.

Type of Industries



2.2 Commerce

Meaning of Commerce

Commerce is that part of business which is concerned with the exchange of goods and services and includes all those activities which directly or indirectly facilitate that exchange.

Commerce deals with the distribution aspect of the business. Whatever is produced it must be consumed, to facilitate this consumption there must be a proper distribution channel. Here comes the need for commerce which is concerned with the smooth buying and selling of goods and services.

Commerce is a very wide term. It involves the process of bringing goods from the place of production to the place of consumption. In other words, it supplies goods to ultimate consumer.

Definition of Commerce

According to James Stephenson, "Commerce is an organized system for the exchange of goods between the members of the industrial world."

Commerce can also be defined as "the sum total of those processes which are engaged in the removal of hindrances of person, place and time in the exchange of commodities.

In an equation form commerce is

TRADE + AIDS TO TRADE

Importance of Commerce

The importance of and Commerce is explained with the help of the following points

1. Commerce tries to satisfy increasing human wants

Human wants are never ending. Commerce has made distribution and movement of goods possible from one part of the world to the other. Today we can buy anything produced anywhere in the world.

2. Commerce helps to increase our standard of living

Standard of living refers to quality of life enjoyed by the members of a society. When a man consumes more products his standard of living improves. Commerce helps us to get what we want at the right time, right place and at the right price and thus helps in improving our standard of living.

3. Commerce links producers and consumers

Production is meant for ultimate consumption. Commerce makes possible to link producers and consumers through retailers and wholesalers and also through the aids to trade. Thus, Commerce creates and facilitates the contact between the centers of production and consumption and links them.

4. Commerce generates employment opportunities

The growth of commerce, industry and trade cause the growth of agencies of trade such as banking, transport, warehousing, insurance, advertising etc. These agencies need people to look after their functioning. Thus, development of commerce generates more and more employment opportunities.

5. Commerce increases national income and wealth

When production increases, national income also increases. It also helps to earn foreign exchange by way of exports and duties levied on imports.

6. Commerce helps in expansion of aids-to-trade

With the growth in trade and commerce there is a growing need for expansion and modernization of aids to trade. Aids to trade such as banking, communication, advertising and publicity, transport, insurance, etc., are expanded and modernised for the smooth conduct of commerce.

7. Commerce encourages international trade

With the help of transport and communication development, countries can exchange their surplus commodities and earn foreign exchange. Thus, commerce ensures faster economic growth of the country.

8. Commerce benefits underdeveloped countries

Underdeveloped countries can import skilled labour and technical know-how from developed countries, while the advanced countries can import raw materials from underdeveloped countries. This helps in laying down the seeds of industrialization in the underdeveloped countries.

9. Commerce helps during emergencies

During emergencies like floods, earthquakes and wars, commerce helps in reaching the essential requirements like foodstuff, medicines and relief measures to the affected areas.

2.3 Hindrances involved in Commerce

Commerce is an organised system which facilitates free flow of goods and services. In business, products and services are produced through industry. The produced goods and services face various types of hindrances to reach the customers. Commerce removes these hindrances and helps to distribute products and reach business desired goal. The following table presents the hindrances involved in the commerce and the Aids remove them;

Hindrances	Removed By
Persons	Trade
Place	Transportation
Time	Warehousing
Finance	Banking
Risk	Insurance
Promotion	Advertisement
Information	Communication

Thus, commerce involves trade and aids to trade.

Following are some of the hindrances in commerce:

1. Hindrance of person

Trade treaty is done by buyers and sellers. In exchange of money, the sellers sell the value of the goods and services to the buyers. Therefore, through the handover of products, personal hindrances can be removed.

2. Hindrance of Place

Goods are produced in a few production centers, whereas consumers are located everywhere. Transportation removes the hindrance of place. It implies conveyance of goods and passengers from one place to another. It creates place utility.

3. Hindrance of Finance

Banking services remove the hindrance of financial problems. It facilitates trade by providing credit in various forms.

4. Hindrance of Time and Duration

There is a time gap between production and consumption. The goods produced are not immediately required for consumption. Warehousing removes the hindrance of time and duration. It preserves the goods from the time of production to the time of consumption. It creates time utility.

5. Hindrance of Risk

Business involves risk. Risk and uncertainty are inherent in any business. Insurance stands for security against heavy risk. So it removes the hindrance of risk. The risk of businessman is reduced by various types of insurance such as, fire insurance, transit insurance, marine insurance, factory insurance, insurance on stocks and assets etc.

6. Hindrance of knowledge and information

Advertisement removes the hindrance of knowledge. It informs the customers about the availability of various products. Communication helps in the efficient operation of commercial activities. So it removes the hindrance of information.

2.4 Branches of Commerce

Commercial activities may be classified into two broad categories.

1. Trade.
2. Aids to trade.

Trade

Trade is a branch of Commerce. It connects buying and selling activities. An individual who does trade is called a trader. Trader transfers the goods from the producer to the consumer. He earns profit from this activity. Other activities of Commerce such as transport, insurance, warehousing, banking and advertising revolve around the trade. In brief, trade is the nucleus of commerce.

Trade may be classified into (a) home trade and (b) foreign trade. Home trade may further be sub-divided into wholesale trade and retail trade. Similarly foreign trade may be sub divided into import, export and entrepot trade. A description of these terms is given below:

1. **Home Trade:** Home trade is also known as 'domestic trade' or 'internal trade'. Home trade is carried on within the boundaries of a nation. Both the buyer and seller belong to the same country. Home trade again is of two types:

a. **Wholesale Trade:** It implies buying and selling of goods in large quantities. Traders who engage themselves in wholesale trade are called 'Wholesalers'. Wholesale serves as a connecting link between the producers and the retailers.

Producers → Wholesalers → Retailers

b. **Retail Trade:** It involves buying and selling of goods in small quantities. Traders engaged in retail trade are called 'retailers'. They serve as a connecting link between wholesalers and consumers. Retail trade is the final stage of distribution.

Wholesalers → Retailers → Consumers

2. **Foreign Trade:** It refers to buying and selling of goods and services between two or more countries through international air ports and sea ports (Foreign trade is also known as 'external trade' or 'international trade'). Foreign trade is again may be classified into three categories as mentioned below:

   a. **Export Trade:** It means the sale of goods to foreign countries. For example, India exports tea to the United Kingdom.

   b. **Import Trade:** It refers to the purchase of goods from foreign countries. For instance, India buys petrol from Iran.

   c. **Entrepot Trade:** It means importing (buying) goods from one country for the purpose of exporting (selling) them to another country. This type of trade is also known as re-export trade.

Aids to Trade

Trade or exchange of goods involves several difficulties, which can be removed by auxiliaries and are known as aids to trade. It refers to all those activities, which directly or indirectly facilitate smooth exchange of goods and services.

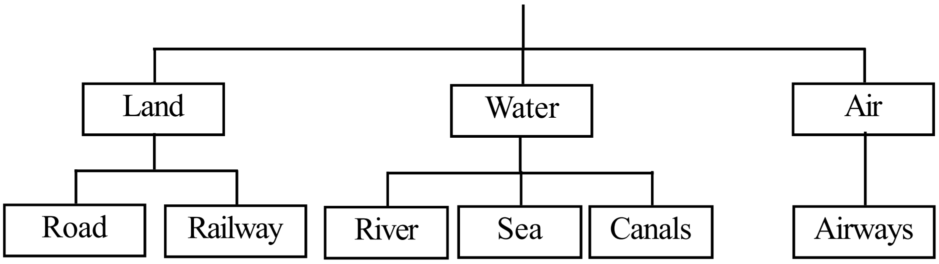
Aids to trade includes Transport, Communication, Warehousing, Banking, Insurance, Advertising. Auxiliaries ensure smooth flow of goods from producers to the consumers.

The various aids to trade in commerce are explained in following points :-

1. Transport

There is a vast distance between centers of production and centers of consumption. This difficulty is removed by transport. Transport creates place utility. There are several kinds of transport such as air, water and land transport. The geographical distance between producers and consumers is removed with the help of transport.

Types of Transport



2. Communication

Communication means transmitting or exchange of information from one person to another. It can be oral or in writing. It is necessary to communicate information from one to another to finalise and settle the terms of sales such as prices of goods, discount allowed, facility of credit, etc. Modern means of communication like telephone, telex, telegraph, email, teleconference, etc., play an important role in establishing contact between businessmen, producers and consumers.

3. Warehousing

There is a time gap between production and consumption. In other words, goods, which are produced at one time, are not consumed at the same time. Hence, it becomes necessary to make arrangements for storage or warehousing. Agricultural commodities like wheat and rice are seasonal in nature but are consumed throughout the year. On the other hand, goods such as umbrellas and woolen clothes are produced throughout the year but are demanded only during particular seasons. Therefore,s goods need to be stored in warehouses till they are demanded. So it creates time utility by supplying the goods at right time to consumer.

4. Insurance

Insurance reduces the problem of risks. Business is subject to risks and uncertainties. These are inevitable in the field of business. Risks may be due to fire, theft, accident or any other natural calamity. Insurance companies who act as risk bearer cover risks. Insurance tries to reduce risks by spreading them out over a larger number of people.

5. Banking

Banking solves the problem of finance. Businessmen receive money and also pay money in large amounts. It is risky to carry large amount of cash from one place to another. Here comes Banking as a solution. Banking and financial institutions solves the problem of payment and facilitate exchange between buyer and seller. The businessmen may also require short-term and long-term funds. Banks provide such finance to businessmen. Banks also advance loans in the form of overdraft, cash credit and discounting of bills of exchange.

6. Advertising

Advertising fills the knowledge gap. Exchange of goods and services is possible only if producers can bring the products to the consumers. Advertising and publicity are important medias of mass communication. Advertising helps the consumers to know about the various brands manufactured by several manufacturers. The medias used to advertise products are Radio, Newspapers, Magazines, TV, Internet, etc.

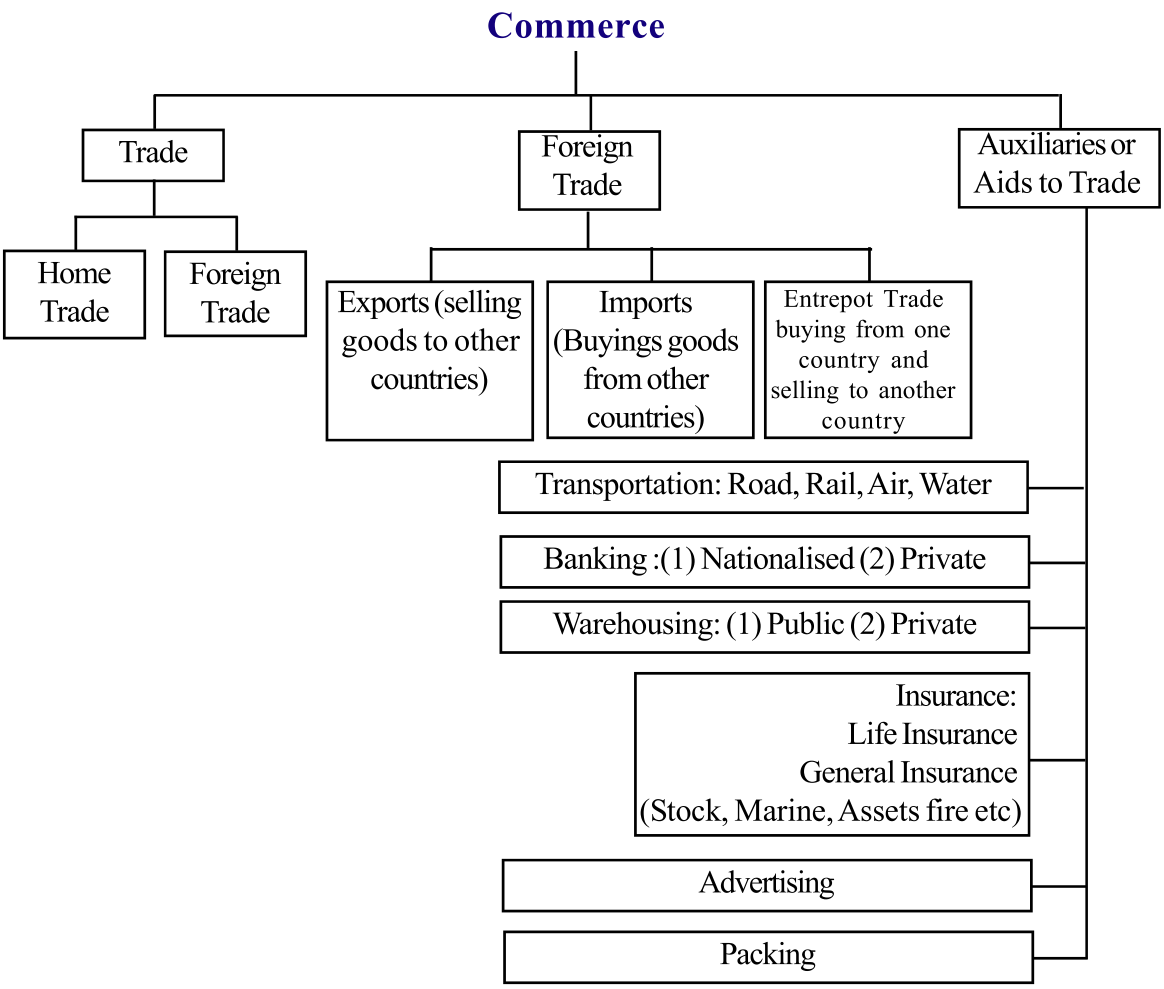
2.5 Inter - Relationship between Industry, Trade and Commerce

Business deals with production and distribution of goods and services. Industry deals with production of goods and services, whereas Commerce deals with the distribution or exchange of goods and services.

Trade deals with buying and selling of goods and services.

BUSINESS = INDUSTRY + COMMERCE

COMMERCE = TRADE + AIDS TO TRADE



2.6 Distinction between Industry, Commerce and Trade

Basis of Distinction	Industry	Commerce	Trade
Meaning	Production of goods and services.	Distribution of goods and services.	Buying and selling of goods and services
Creation of Utility	Creates form utility	Creates utilities of person, place, time, etc.	Creates only possession utility.
Capital	Requires huge capital	Requires less capital	Requires less capital
Risk	High risk than Commerce	Low risk than Industry	Low risk than Industry
Elements	a. Genetic. b. Extractive. c. Manufacturing. d. Construction.	a. Trade. b. Aids to trade.	a. Home trade b. Foreign trade
Place of Work	Firms, factories, mines, workshops	From one place to Another	Market.
Ownership and Control	By industrialists	By merchants	By traders.

Summary

Industry

Production of consumer goods and capital goods, creates form utility. Genetic, Extractive, Manufacturing – analytical, synthetical, processing and assembling, Construction.

Commerce

Distribution of goods and services. Economic activity, Exchange of goods and services, Profit motive, Regularity of transactions, Creation of utilities, Part of business, Comprises trade and aids to trade, removes hindrances of person, place, time, exchange and knowledge.

Trade

Buying and selling. Home trade- Wholesale and Retail, Foreign trade- Export, Import, Entrepot.

Aids to Trade

Transport, Warehousing, Insurance, Banking, Advertising andPublicity, Packing, Communication etc.

Questions

I. Essay Type Questions

1. What is meant by industry? Explain various types of industries with suitable examples.
2. What is Commerce? Describe the various branches of Commerce.
3. Define Trade and explain the various types of aids to trade.
4. Explain the inter-relationship between trade, commerce and industry.
5. Narrate the importance of Commerce.
6. Explain the hindrances involved in Commerce.
7. Distinguish Industry, Commerce and Trade.

II. Short Answer Questions

1. Why Communication is required as an Aid to Trade?
2. What do you understand by Commerce?
3. Why warehousing is needed?
4. State the Types of Foreign Trade.
5. Explain the Classification of Industries.
6. How Foreign Trade is classified?

III. Very Short Answer Questions

1. Industry
2. Commerce
3. Trade
4. Home trade
5. Entrepo-trade
6. Transportation
7. Warehousing
8. Genetic Industries
9. Extractive industries
10. Banking
11. Wholesale Trade
12. Foreign Trade
13. Processing Industry
14. Synthetic Industry
15. Assembling Industry

Student Activity

1. Observe the activities of a retailer who purchases goods from wholesaler and sells the same to consumers to earn profit and present a report on your Observations.
2. Obsere the category of industry in the nearby business area and present a report on it.

Unit - II

Forms of Business Organisation

Sole Proprietorship

CHAPTER
3

3.1 Concept of Business Organisation

Business organisation is an organised entity having group of people working together to achieve a common goal. In order to achieve the desired goal, organisations mobilise capital or finance, employ labour or man power and other resources like land and building, plant and machinery, furniture and fittings etc. Finally, all these resources are put together in a useful manner to achieve the end results.

To carry out any business and to achieve its objective of earning profit, it is required to bring together all the resources and put them into action in a systematic way, coordinate and control all these activities properly. This arrangement is known as Business Organisation. Thus, Busines organisation is an entity that is formed for the purpose of carrying on the commercial enterprise of buying and selling. It is concerned with management and planning of different activitues of a busines concern.

3.2 Forms of Business Organisation

Arrangement of ownership and management of business organisations is termed as '***Form of Business Organisation***'. Business organisations may be owned and managed by a single individual (***Sole Proprietorship***) or a group of individuals (***Partnership***) or in the form of a company (***Joint Stock Company***). In India, business organisations usually take the following forms.

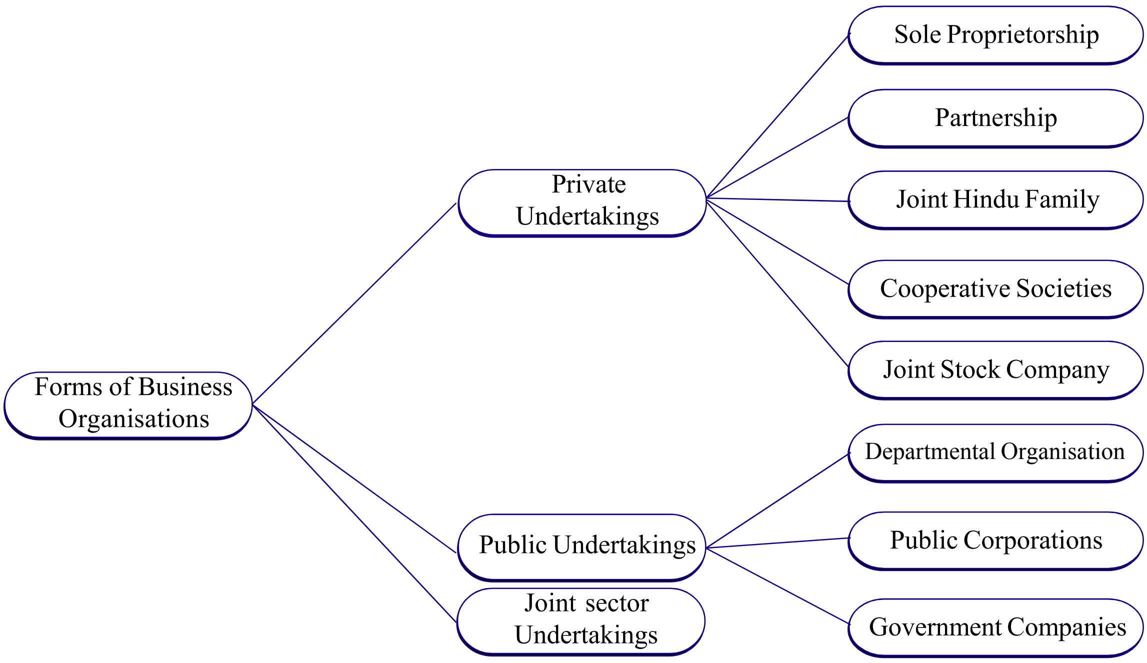


Figure - 3.1 : Forms of Business Organisation

3.3 Sole Proprietorship

Meaning

Sole proprietorship is a form of business organisation in which a single individual introduces his own capital, skill and intelligence in the management of its affairs and is solely responsible for the results of its operations. The individual may run the business on his own or may obtain the assistance of employees. It is the first stage in the evolution of the forms of organisation and is, thus, the oldest among them.

Also known as ***Individual Entrepreneurship***, it is the easiest to form and is also the simplest in organisation. All that is required is that the individual concerned should decide to carry on some particular business and find the necessary capital. For this purpose, he may depend mostly on his own savings, or else, he may borrow part or whole from his friends or relatives. The business may be started either in a portion of the proprietor's own house or on rented premises. There are no legal formalities to be followed except those required for a particular type of business.

A sole proprietor contributes and organises the resources in a systematic way and controls the activities with the objective of earning profit.

Definition

J.L. Hanson: "A type of business unit where one person is solely responsible for providing the capital and bearing the risk of the enterprise, and for the management of the business."

Kimball and Kimball: "Sole Proprietorship is a form of business where the individual proprietor is the supreme judge of all matters pertaining to his business"

Features

(a) **Single Ownership:** The sole proprietorship form of business organisation has a single owner who himself/herself starts the business by bringing together all the resources.

(b) **No Separation of Ownership and Management:** The owner himself/herself manages the business as per his/her own skill and intelligence. There is no separation of ownership and management as is the case with company form of business organisation.

(c) **Less Legal Formalities:** The formation and operation of a sole proprietorship form of business organisation involves less legal formalities. Thus, its formation is quite easy and simple.

(d) **No Separate Entity:** The business unit does not have an entity separate from the owner. The businessman and the business enterprise are one and the same, and the businessman is responsible for everything that happens in his business unit.

(e) **No Sharing of Profit and Loss:** The sole proprietor enjoys the profits alone. At the same time, the entire loss is also borne by him. No other person shares the profits and losses of the business. He alone bears the risks and reaps the profits.

(f) **Unlimited Liability:** The liability of the sole proprietor is unlimited. In case of loss, if his business assets are not enough to pay the business liabilities, his personal property can also be utilised to pay off the liabilities of the business.

(g) **One-man Control:** The controlling power of the sole proprietorship business always remains with the owner. He/she runs the business as per his/her own will.

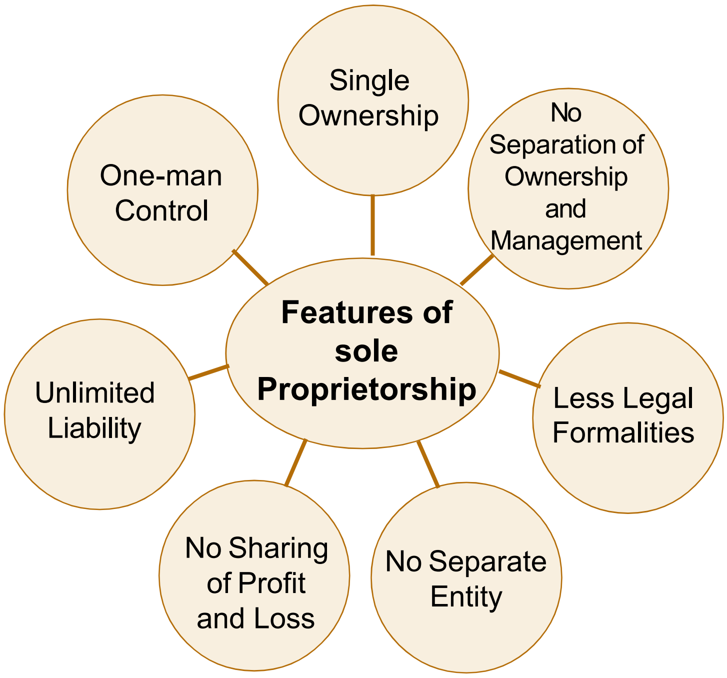


Figure - 3.2 : Features of sole proprietorship

Merits

(a) Easy to Form and Wind Up: It is very easy and simple to form a sole proprietorship form of business organisation. Less legal formalities are required to be observed. Naturally, the business can be wind up any time if the proprietor so decides.

(b) Quick Decision and Prompt Action: As stated earlier, nobody interferes in the affairs of the sole proprietary organisation. So he/she can take quick decisions on the various issues relating to business and accordingly prompt action can be taken.

(c) Direct Motivation: In sole proprietorship form of business organisations the entire profit of the business goes to the owner. This motivates the proprietor to work hard and run the business effectively and efficiently..

(d) Flexibility in Operation: It is very easy to initiate and implement changes as per the requirements of the business. The expansion or curtailment of business activities does not require many formalities as in the case of other forms of business organisation.

(e) Maintenance of Business Secrets: The business secrets are known only to the proprietor. He is not required to disclose any information to others unless and until he himself so decides. He is also not bound to publish his business accounts.

(f) Personal Touch: Since the proprietor himself handles everything relating to business, it is easy to maintain a good personal contacts with the customers and employees. By knowing the likes, dislikes and tastes of the customers, the proprietor can adjust his operations accordingly. Similarly, as the employees are very few and work directly under a single proprietor, it helps in maintaining a harmonious relationship with them, and the business can be run smoothly.

Limitations

(a) Limited Resources: The resources of a sole proprietor are always limited. Being the single owner, it is not always possible to arrange sufficient funds from his own sources. Again borrowing funds from friends and relatives or from banks has its own implications. So, the proprietor has a limited capacity to raise funds for his business.

(b) Lack of Continuity: The continuity of the business is linked with the life of the proprietor. Illness, death or insolvency of the proprietor can lead to closure of the business. Thus, the continuity of business is uncertain.

(c) Unlimited Liability: In the eyes of law, the proprietor and the business are one and the same. So personal properties of the owner can also be used to meet the business obligations and debts.

(d) Not Suitable for Large - Scale Operations: Since the resources and the managerial ability is limited, sole proprietorship form of business organisation is not suitable for large-scale businesses.

(e) Limited Managerial Expertise: A sole proprietorship form of business organisation always suffers from lack of managerial expertise. A single person may not be an expert in all fields like purchasing, selling, financing etc. Again, because of limited financial resources, and the size of the business, it is also not possible to engage the professional managers in sole proprietorship form of business organisations.

Summary

A business enterprise can be owned and organized in several forms. Each form of organization has its own merits and demerits. The ultimate choice of the form of business depends upon the balancing of the advantages and disadvantages of the various forms of business. The right choice of the form of the business is very crucial because it determines the power, control, risk and responsibility of the entrepreneur as well as the division of profits and losses. Being a long term commitment, the choice of the form of business should be made after considerable thought and deliberation.

Sole proprietorship is a form of business organisation in which an individual invest his own capital, uses his own skill and intelligence in the management of its affairs and is solely responsible for the results of its operations.

Questions

I. Essay Type Questions

1. Define Sole Proprietorship and discuss its merits and demerits.
2. "One man management is best in the world provided one man is big enough to take care of everything". Discuss.
3. Explain the features of sole Proprietorship.

II. Short Answer Questions

1. What is sole proprietorship?
2. What is meant by Business Organisation?
3. Explain the limitations of Sole trader.
4. Why sole trading is a better Business Organisation?

III. Very Short Answer Questions

1. Business Organisation
2. Individual Entrepreneurship.
3. Unlimited Liability
4. One man Control.
5. Business Secrets.
6. Single Ownership.

Student Activity

Visit the small business firms and collect the information about the benefits and drawbacks and problems of such business units.

Joint Hindu Family Business and Cooperative Society

CHAPTER

4

Introduction

There are a different forms of business organizations viz., Sole trader,Partnership, Hindu undivided family, and Cooperative Societies. Of course there is a large formal organization known as Joint Stock Company. About Partnership and Joint stock companies, an elaborate discussion is presented in chapter five and chapter six respectively. This chapter is devoted to explain Joint Hindu Family Business and Cooperative Society.

4.1 Joint Hindu Family form of Business Organisation

Meaning

The Joint Hindu Family (JHF) business is a form of business organisation run by Hindu Undivided Family (HUF), where in the family members of three successive generations own the business jointly. The head of the family known as ***'Karta'*** manages the business. The other members are called ***'co-parceners'.*** All of them have equal ownership right over the properties of the business.

The membership of the JHF is acquired by virtue of birth in the same family. There is no restriction for minors to become the members of the business. The Joint Hindu

Family business is governed by two laws viz., the 'Dayabhaga' and 'Mitakshara'. As per ***'Dayabhaga'*** system of Hindu Law, both male and female members are the joint owners. Mitakshara refers to son's right by birth in the joint family property. The interests of all the sons are equal. The following are the features of two Schools of Joint Hindu Family business.

a. **Mitakshara:** This shcool of HUF prevails in entire India except in Assam and West Bengal. Family members of male and their wives, unmarried daughters are its members. By birth in the family, he gets the right on existing property. By birth a a member gets a share in common property, it continues till his death. In this way shares in the property gets fluctuates in accordance with number of coparceners. In other words, living members will have right on the joint property.

   In this forms of organisation an widow does not have a claim in the property, but she can ask for her maintainance.

b. **Dayabhaga:** This school of Hindu law prevailes only in Assam and West Bengal States. All the provisions of Mitakshara hold good except some features. Under this the right of property comes to a coparcener by succession and not by birth. Share/ Claim on a joint family, does not fluctuates, on the basis of birth and death of a member.

   Under this Kartha has all rights on property. The right would be passed on to next generation only on death of Kartha.

Features

The essential features of the Joint Hindu Family business are as under.

(a) **Formation:** In JHF business there must be at least two members in the family, having some ancestral property. It is not created by an agreement but by operation of law.

(b) **Legal Status:** The JHF business is a jointly owned business. It is governed by the Hindu Succession Act, 1956.

(c) **Membership:** Outsiders are not allowed to become the coparcener in the JHF business. Only the members of undivided family acquire coparcenership rights by birth.

(d) Profit Sharing: All coparceners have equal share in the profits of the business.

(e) Management: The business is managed by the senior most member of the family known as 'Karta'. Other members do not have the right to participate in the management. The Karta has the authority to manage the business as per his own will. His ways of managing cannot be questioned. If the coparceners are not satisfied, the only remedy is to get the HUF status of the family dissolved by mutual agreement.

(f) Liability: The liability of coparceners is limited to the extent of their share in the business. But the Karta has an unlimited liability. His personal property can also be utilised to meet the business liability.

(g) Continuity: Death of any coparceners does not affect the continuity of business. Even on the death of the Karta, it continues to exist as the eldest of the coparceners takes position of Karta. However, JHF business can be dissolved either through mutual agreement or by partition suit in the court.

Advantages and Disadvantages of Joint Hindu Family Firm

Advantages: The advantages of a Joint Hindu Family business organisation are as follows:

1. **Continuity :** It is not dissolved by the death or insanity of a coparcener.
2. **Centralized and Efficient Management:** The management of Joint Hindu Family firm is vested in the hands of karta only. This results in the unity of command and disciplined management.
3. **No Limit to Membership**: By birth every coparcener will automatically become a member in Hindu Undivided Family. Hence, there is no limit to membership.
4. **Better Credit:** Its credit worthiness is better than that of the Sole Trader.

Disadvantages: The disadvanatages of a Joint Hindu Family Firm are as follows:

1. **No Direct Correlation between Efforts and Rewards:** Kartha alone looks after the business of Joint Hindu Undivided Family. But benefits are shared among all coparceners. Qualities like idleness and laziness and stay at home are cultivated among coparceners.
2. **Limited Managerial Ability:** For expansion and growth of the busienss in Joint Hindu Undivided Family, the management and control of the business becomes difficult, as the Kartha alone has to manage.

3. **Limited Capital and Financial Resources:** The capital and financial resources of the Joint Hindu Undivided Family firm are limited as compared withPartnership and Joint Stock Company.

   Jint Hindu Undivided family is considerably declined due to influence of western individual family system.

4.2 Cooperative Society

Meaning

The term '***Cooperation***' is derived from the Latin word 'co-operari'. The word 'Co' means '***with***' and '***operari***' means '***to work***'. Thus, the term cooperation means working together. So, those who want to work together with some common economic objective can form a society, which is termed as '***Cooperative Society***'.

Cooperative Society is a voluntary association of persons who work together to promote their economic interests. It works on the principle of self-help and mutual help. The primary objective is to provide support to the members. The motto of a cooperative society is "Each for all and all for each". People come forward as a group, pool their individual resources, utilise them in the best possible manner and derive some common benefits out of it.

Definition

The Indian Cooperative Societies Act 1912, Section (4) defines Cooperative Society as "a society, which has its objectives for the promotion of economic interests of its members in accordance with cooperative principles."

H.C.Calvert defines A cooperative society 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."

Features

Based on the above definition the following characteristics of cooperative society form of business organisation can be identified.

(a) **Voluntary Association:** Members join the cooperative society voluntarily i.e., by their own choice. Persons havingcommon economic objective can join the society as and when they like, continue as long as they like and leave the society as and when they want.

(b) Open Membership: The membership is open to all those having a common economic interest. Any person can become a member irrespective of his/her caste, creed, religion, colour, sex etc.

(c) Number of Members: A minimum of 10 members are required to form a cooperative society. In case of multi-state cooperative societies, the minimum number of members should be 50 from each state in case the members are individuals. The Cooperative Society Act does not specify the maximum number of members for any cooperative society. However, after the formation of the society, the member may specify the maximum number of members.

(d) State Control: Since the registration of cooperative societies is compulsory, every cooperative society comes under the control and supervision of the Government. The Cooperative Department keeps a watch on the functioning of the societies. Every society has to get its accounts audited from the Cooperative Department of the government.

(e) Capital: The capital of the cooperative society is contributed by its members. Since the members' contribution is very limited, it often depends on the loan from government, and apex cooperative institutions or on the grants and assistance from State and Central Governments.

(f) Democratic Set Up: The cooperative societies are managed in a democratic manner. Every member has a right to take part in the management of the society. However, the society elects a managing committee for its effective management. The members of the managing committee are elected on the basis of 'one-man one-vote' irrespective of the number of shares held by any member. It is the general body of the society which lays down the broad framework within which the managing committee functions.

(g) Service Motive: The primary objective of all cooperative societies is to provide services to its members.

(h) Return on Capital Investment: The members get returns on their capital investment in the form of dividend.

(i) Distribution of Surplus: After giving a limited dividend to the members of the society, the surplus profit is distributed in the form of bonus, keeping aside a certain percentage as reserve and for general welfare of the society.

Registration of the Society

In India, cooperative societies are registered under the Cooperative Societies Act 1912 or under the State Cooperative Societies Act. The Multi-state Cooperative Societies are registered under the Multi-state Cooperative Societies Act 2002. Once registered, the society becomes a separate legal entity and enjoys the following privileges;

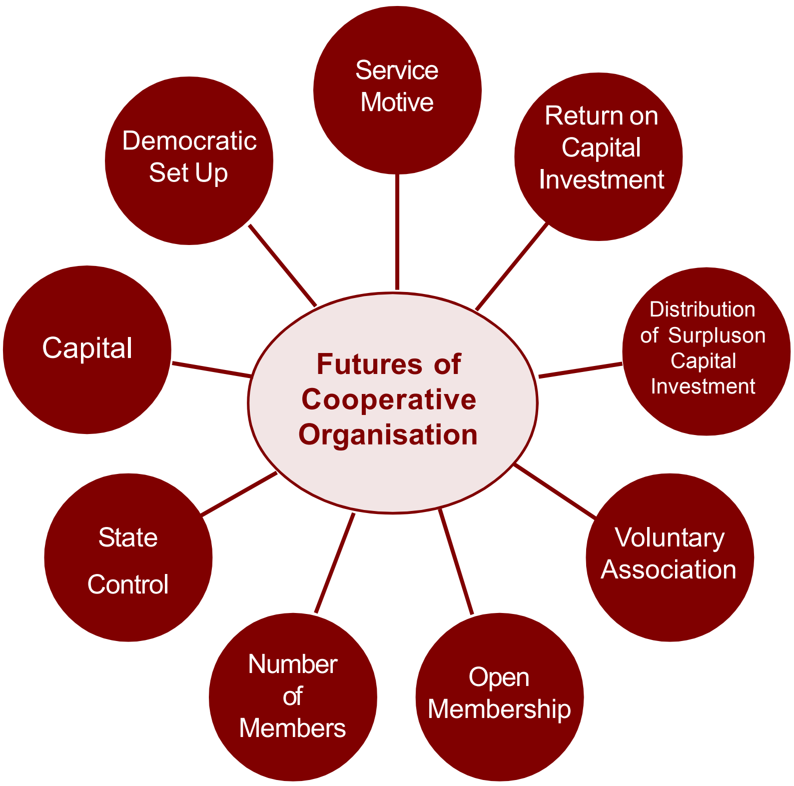
i. The society enjoys perpetual succession

ii. It has its own common seal

iii. It can enter into agreements with others

iv. It can sue others in a court of law

v. It can own properties in its name



Types of Cooperative Societies

According to the needs of the people, we find different types of cooperative societies in India. Some of the important types are given below;

1. **Consumers' Cooperative Societies:** These societies are formed to protect the interest of consumers by making available consumer goods of high quality at reasonable price.
2. **Producer's Cooperative Societies:** These societies are formed to protect the interest of small producers and artisans by making available items of their need for production, like raw materials, tools and equipments etc.
3. **Marketing Cooperative Societies:** Small producers form together as Marketing Cooperative Societies to solve the marketing problems of their products.
4. **Housing Cooperative Societies:** The Housing cooperative societies are formed generally in urban areas to provide residential housing facilities to their members.
5. **Farming Cooperative Societies**: These societies are formed by the small farmers to get the benefit of large-scale farming.
6. **Credit Cooperative Societies:** These societies are started by persons who are in need of credit. They accept deposits from the members and grant them loans at reasonable rate of interest.

Advantages and Disadvantages of Cooperative Society

Advantages

The advantages of cooperative societies are given below:

1. **Simple Formation:** It is easy and simple to form a cooperative society. There is no need to comply with a number of legal formatlities as in the case of a joint stock company. Any ten adult members can form a society. The procedure for registration is very simple.
2. **Democratic Management:** Every member has only one vote irrespective of the number of shares held by him. Meetings are well attended and voting by proxy is not allowed. As such the management of the society is democratic.
3. **Low Operating Costs:** The administrative expenses of a cooperative society are usually low. Many members provide administrative services honorarily.
4. **Service Motive:** Cooperative societies are started not for profit but for service. The members are provided with goods at cheaper rates. Financial help is also given to members at concessional rates. A feeling of cooperation is created among members.

5. **Limited Liability:** The liability of every member is limited to the extent of his capital contribution as there is no risk of losing their meager private assets.

6. **Continuity for Stability:** It's life is not affected by the death, insolvency, conviction retirement etc., of its members.

7. **Tax Advantages:** A cooperative society is exempted from income tax and surcharge on its earnings up to a certain limit. It is also exempted from stamp duty and registration fees.

8. **State Patronage:** State has adopted a helpful policy towards cooperatives as an instrument of socio-economic development of weaker section of society by providing financial assistance in the form of loans and grants.

9. **No Speculation in Shares:** In a cooperative society, any person can buy shares at any time. Membership is always open to new members. So there is no possibility of speculative dealings in the shares of cooperatives.

10. **Social Utility:** Co operative form of organization provides education and training in democracy, self government, self-help and mutual help and spirit of service among members.

11. **Check on the Business:** When business men try to exploit consumers by raising prices of their commodities, cooperatives supply goods at reasonable prices. The cooperatives are a check on other forms of business organizations.

12. **Elimination of Middlemen:** Co operative socieites eliminate middlemen from the channel of distibution as they purchase goods directly from producer and sell them to the members at cheap rates and better quality. Exploitation of consumes is avoided.

13. **Aim of Mutual Prosperity:** Cooperatives function on the principle of "Each for all and all for each" with the aim of mutual prosperity.

Disadvantages

The disadvanatages of cooperative societies are as follows:

1. **Inefficient Management:** There is possibility that the Management committee members may not take proper interest in the management as they are paid only

honorarium for their services. Besides, cooperative society cannot afford to employ persons with necessary ability, knowledge and experience unlike company form of organization.

2. **Limited Financial Resources:** Restriction on dividend and the principle of "one member, one vote" discourage rich people from joining the society. Due to shortage of funds, there is limited scope for expansion and growth.

3. **Lack of Unity Among Members:** Many cooperatives fail because of constant group rivalry and quarrels among members.

4. **Lack of Incentive to Work Hard:** Management committee members do not take an active part and interest in the management and the affairs of the society, as they are not paid for their service even though the society makes huge profits.

5. **Non-transferability of Shares:** A member cannot transfer his shares freely but he can be allowed to withdraw his capital.

6. **Rigid State Control:** Societies have to follow the rules and regulations of the Cooperative Societies Act and the Government.

7. **No universal Application:** It is suitable mainly for small and medium size enterprises.

8. **Lack of Secrecy:** The affairs of a cooperative society are exposed to all the members. So it is difficult to maintain secrecy of business matters.

9. **Absence of Loyalty:** The loyalty of the members of a cooperative society may not be always assured and cannot be enforced.

10. **Political Interference:** Government nominates members to the managing committees. Every Government tries to send their own party members to these societies.

11. **Lack of Competitive Strength:** Cooperative societies with limited resources are not able to effectively compete with large scale manufacturers who are able to reduce costs and overheads by mass production.

Summary

In a Joint Hindu Family business, the members of a Hindu joint family own the business jointly. Only the male members of the family upto three successive generations become members by virtue of their birth. They are called 'Co-parceners'. The senior most co-parcener is called the 'Karta'. Joint Hindu Family form of business has benefits and also has some limitations.

A co-operative society is formed particularly to provide services to its members and to the society in general. Individuals, producers, consumers, farmers etc., who are in need and wish to protect themselves can go for co-operatives.

Questions

I. Essay Type Questions

1. What is Joint Hindu Family Business? Discuss its main features.
2. Define the Cooperative Society. Explain its features.
3. A cooperative form of organisation is a method of 'Self Help' – Discuss.
4. State the advantages and disadvantages of Hindu undivided family business organization.
5. Discuss the merits and demerits of coopeative form of organization

II. Short Answer Type Questions

1. Briefly explain the different types of cooperative societies.
2. What privileges are enjoyed by Registered Co-operative Society?

II. Very Short Answer Type Questions

1. Karta.
2. Coparcener.
3. Dayabhaga.
4. Mitakshara.
5. Registration of Cooperative Society.
6. Housing Co-operative Society.
7. Producers Co-operative Society.
8. Credit Co-operative Society
9. Consumer Co-operative Society
10. Joiont Hindu Family Business.

Student Activity

Visit the Co-operative societies and get information about the types of society and its organisation. Try and analyse the advantages and limitations of co-operative Societies.

Partnership

CHAPTER
5

5.1 Meaning and Definition

From the experiences of Sole Proprietoryship and the Joint Hindu Family form of organisation, it is noticed that these organizations have some inherent disadvantages and difficulties in their functioning. In order to overcome these problems Partnership form of organizations has emerged as a viable option.

'Partnership' is an association of two or more persons who pool their financial and managerial resources and agree to carry on a business and share its profit or losses. The persons who form a partnership are individually known as 'partners' and collectively a firm or 'partnership firm'. Partnership is an ideal form of organisation for small and medium size organisations which have limited capital and other resources, limited scale of production and market, limited specialization in management etc.

Definitions

Section 4 of the Partnership Act, 1932 defines partnership as "the relation between persons who have agreed to share the profits of a business carried on by all or any one acting for all".

L.H.Haney "Partnership is the relation existing between persons competent to make contract, who agree to carry on a lawful business in common with a view to private gain".

John Shubin "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 business".

5.2 Features

The following are the features of partnership form of business organisation.

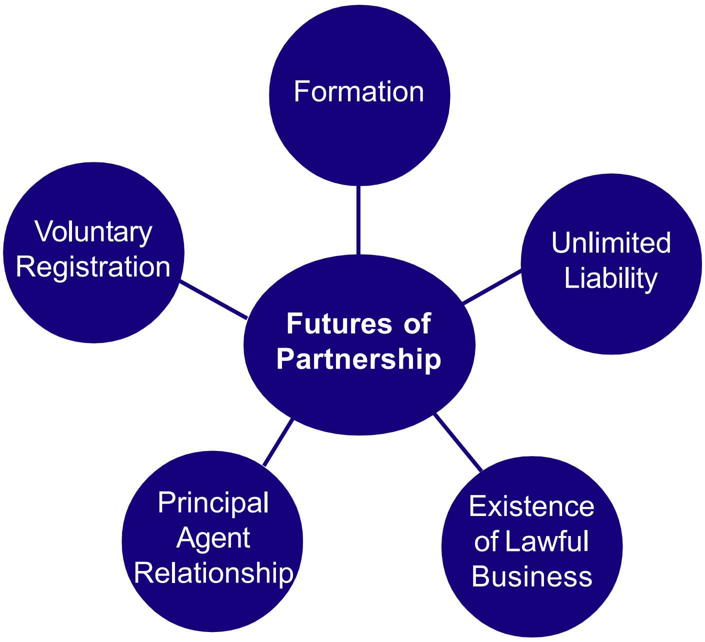


Figure 5.1 : Features of Partnership

(a) Formation: The Partnership form of business organisation is governed by the provisions of Indian Partnership Act, 1932. It comes into existence through a legal agreement wherein the terms and conditions governing the relationship among the partners, sharing of profits and losses and the manner of conducting the business are specified must be lawful and run with the profit motive. However, two people coming together for charitable purposes will not constitute a partnership.

(b) Unlimited Liability: The partners of a firm have unlimited liability. Personal assets may be used for repaying debts in case the business assets are insufficient. Further, the partners are jointly and individually liable for payment of debts. Jointly, all the partners are responsible for the debts and they contribute in proportion to their share in business and as such are liable to that extent. Individually too, each partner can be held responsible for the repayment of the debts of the business.

(c) Existence of Lawful Business: The business, of which the persons have agreed to share the profit, must be lawful. Any agreement to indulge in smuggling, black marketing etc., cannot be called partnership business in the eyes of law.

(d) Principal Agent Relationship: There must be an agency relationship between the partners. Every partner is the principal as well as the agent of the firm. When a partner deals with other parties he/she acts as an agent of other partners and at the same time the other partners become the principal.

(e) Voluntary Registration: The registration of a partnership firm is not compulsory. But an unregistered firm suffers from some limitations which make it virtually compulsory to be registered.

5.3 Types of Partners

A partnership firm can have different types of partners with different roles and liabilities. An understanding of these types is important for a clear understanding of their rights and responsibilities. These are described as under:

I. Based on the extent of Participation in the day-to-day management of the firm, partners can be classified as

1. **'Active Partners'** or **'Working Partners'**. The partners who actively participate in the day-to-day operations of the business are known as active partners or working partners.

2. **Sleeping Partners:** Those partners who do not participate in the day-to-day activities of the business are known as *'sleeping'* or *'dormant'* partners. Such partners simply contribute capital and share the profits and losses.

II. Based on Sharing of Profits, the partners may be classified as

1. **Nominal Partners:** Nominal partners allow the firm to use their name as partner. They neither invest any capital nor participate in the day-to-day operations. They are not entitled to share the profits of the firm. However, they are liable to third parties for all the acts of the firm.

2. **Partners in Profits:** A person who shares the profits of the business without being liable for the losses is known as partner in profits. This is applicable only to the minors who are admitted to the benefits of the firm and their liability is limited to their capital contribution.

III. Based on Liability, the partners can be classified as

1. **Limited Partners:** The liability of limited partners is limited to the extent of their capital contribution. This type of partners is found in Limited Partnership firms in some European countries and USA. So far, it is not allowed in India. However, the Limited Liability Partnership Act is very much under consideration of the Parliament.

2. **General Partners**: The partners having unlimited liability are called as general partners or Partners with unlimited liability. It may be noted that every partner who is not a limited partner is treated as a general partner.

IV. Based on the Behaviour and Conduct Exhibited. There are two more types of partners. These are

1. **Partner by Estoppel:** A person, who behaves in the public in such a way as to give an impression that he/she is a partner of the firm, is called 'partner by estoppel'. Such partners are not entitled to share the profits of the firm, but are fully liable if somebody suffers because of his/her false representation.

2. **Partner by Holding out:** A partner or partnership firm declares that a particular person is a partner of their firm, and such a person does not disclaim it, then he/she is known as 'Partner by Holding out'. Such partners are not entitled to profits but are fully liable as regards the firm's debts.

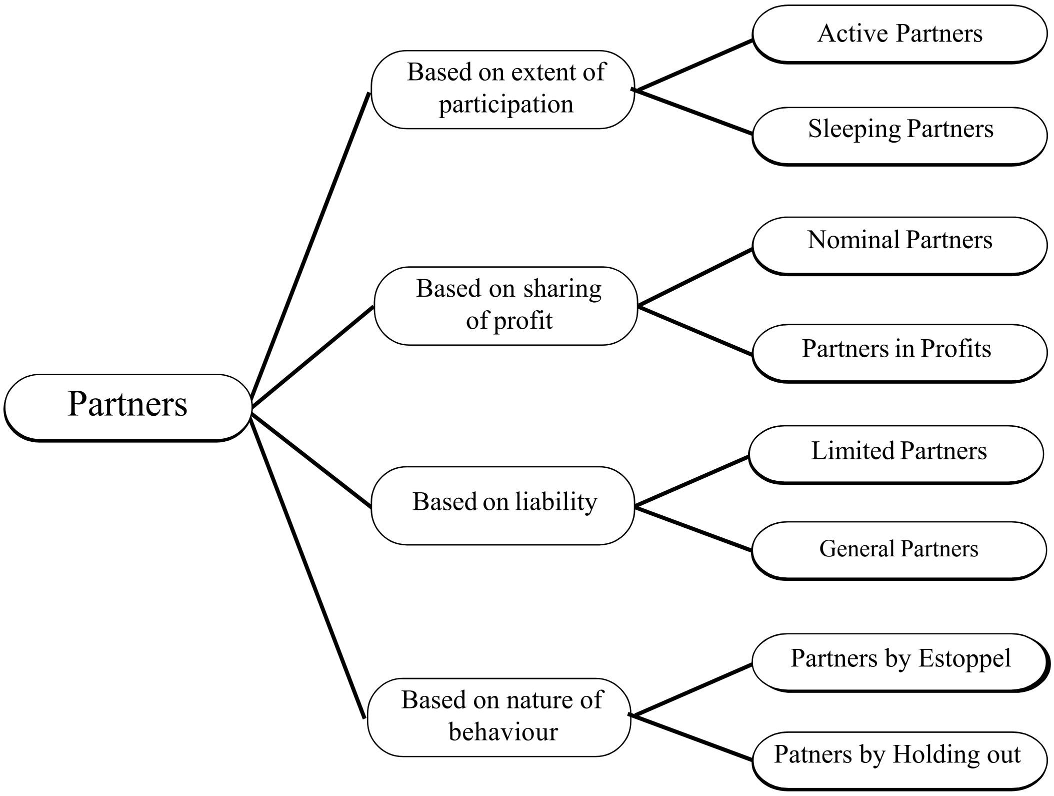


Figure 5.2 : Types of Partners

5.4 Advantages and Limitations

Advantages

The advantages of partnership are given below;

(a) Easy to Form: A partnership can be formed easily without many legal formalities. Since it is not compulsory to get the firm registered, a simple agreement, either in oral, writing or implied is sufficient to create a partnership firm.

(b) Availability of Larger Resources: Since two or more partners join hands to start partnership firm, it may be possible to pool more resources as compared to sole proprietorship form of business organisation.

(c) Better Decisions: In partnership firm, each partner has a right to take part in the management of the business. All major decisions are taken in consultation with and with the consent of all partners. Thus, collective wisdom prevails and there is less scope for reckless and hasty decisions.

(d) Flexibility: The partnership firm is a flexible organisation. At any time the partners can decide to change the size or nature of business or area of its operation after taking the necessary consent of all the partners.

(e) **Sharing of Risks:** The losses of the firm are shared by all the partners equally or as per the agreed ratio.

(f) **Keen Interest:** Since partners share the profit and bear the losses, they take keen interest in the affairs of the business.

(g) **Benefits of Specialisation:** All partners actively participate in the business as per their specialisation and knowledge. In a partnership firm providing legal consultancy to people, one partner may deal with civil cases, one in criminal cases, and another in labour cases and so on as per their area of specialisation. Similarly two or more doctors of different specialisation may start a clinic in partnership.

(h) **Protection of Interest:** In partnership form of business organisation, the rights of each partner and his/her interests are fully protected. If a partner is dissatisfied with any decision, he can ask for dissolution of the firm or can withdraw from the partnership.

(i) **Secrecy:** Business secrets of the firm are known to the partners only. It is not required to disclose any information to the outsiders. It is also not mandatory to publish the annual accounts of the Partnership firm.

Limitations

A partnership firm suffers from the following limitations;

(a) **Unlimited Liability:** The most important drawback of partnership firm is that the liability of the partners is unlimited i.e., the partners are personally liable for the debts and obligations of the firm. In other words, their personal property can also be utilised for payment of firm's liabilities.

(b) **Instability:** Every partnership firm has uncertain life. The death, insolvency, incapacity or the retirement of any partner brings the firm to an end. Not only that any dissenting partner can give notice at any time for dissolution of partnership.

(c) **Limited Capital:** Since the total number of partners cannot exceed 20, the capacity to raise funds remains limited as compared to a joint stock company where there is no limit on the number of shareholders.

(d) **Non-transferability of Share:** The share of interest of any partner cannot be transferred to other partners or to the outsiders. So it creates inconvenience for the partner who wants to transfer his share to others fully and partly. The only alternative is dissolution of the firm.

(e) Possibility of Conflicts: Every partner in the firm has an equal right to participate in the management. Every partner can place his or her opinion or viewpoint before the management regarding any matter at any time. Because of this, sometimes there is friction and quarrel among the partners. Difference of opinion may give rise to quarrels and lead to dissolution of the firm.

5.5 Registration of Partnership

The Indian Partnership Act, 1932 does not make it compulsory for a firm to be registered; but there are certain disabilities which attach to an unregistered firm. These disabilities make it virtually compulsory for a firm to be registered. Registration can take place at any time. The procedure for registration of a firm is as follows:

1) The firm will have to apply to the Registrar of Firms of the state concerned in the prescribed form.

2) The Registration form contains the following particulars and it should be accompanied by a fee of Rs.3/- and to be sent to the Registrar of Firms.

   a. The name of the firm

   b. Location of the firm

   c. Names of other places where the firm carries on business

   d. The name in full and addresses of the partners

   e. The date on which various partners joined the firm

   f. The duration of the firm

3) The duly filled in form must be signed by all the partners. The filled in form along with prescribed registration fee must be deposited in the office of the Registrar of Firms.

4) The Registrar will scrutinise the application, and if he is satisfied that all formalities relating to registration have been duly complied with, he will put the name of the firm in his register and issue the Certificate of Registration.

5.6 Partnership Deed

Partnership deed is a document containing the terms and conditions of a partnership. It is an agreement in writing signed by all the partners duly stamped and registered. The Partnership deed defines certain rights, duties and obligations of partners and governs relations among them in the conduct of business affairs of the firm. It is not a public document. The partnership deed must not contain any term which is contrary to the provisions of the Partnership Act. The deed has to be stamped in accordance with the Indian Stamps Act 1899. Each partner should have a copy of the deed. The following points are generally be included in the deed.

1) Name of the firm
2) Nature of the business
3) Names and addresses of partners
4) Location of business
5) Duration of partnership, if decided
6) Amount of capital to be contributed by each partner
7) Profit and loss sharing ratio
8) Duties, powers and obligations of partners
9) Salaries and withdrawals of the partners
10) Preparation of accounts and their auditing
11) Procedure for dissolution of the firm
12) Procedure for settlement of disputes

5.7 Rights and Duties of Partners

The rights and duties of the partners of a firm usually governed by the partnership agreement (Agreement Deed) among the partners. The Partnership agreement, contains the rights and duties of partners, may be expressed or implied from the course of dealings among the partners. In case the Partnership Deed does not specify them, then the partners will have rights and duties as laid down in the Indian Partnership Act, 1932.

Rights of a Partner

1. Right to take part in the conduct and management of the firm's business.
2. Right to be consulted and expressed his opinion on any matter related to the firm.
3. Right to have access to inspect and copy any books of accounts and records of the firm.
4. Right to have an equal share in the profits of the firm, unless and otherwise agreed by the partners.
5. Right to receive interest on loan and advances made by partner to the firm.
6. Right to be indemnified for the expenses incurred and losses sustained by partner to the firm.
7. Right to the Partnership property unless and otherwise mentioned in the partnership deed.
8. Every partner has power or authority, in an emergency, to do any such acts, for the purpose of protecting the firm from losses.
9. Right to prevent the introduction of a new partner without the consent of other partners.
10. Right to act as an agent of the Partnership firm in the ordinary course of business.

Duties of a Partner

1. Should act diligently and honestly in the discharge of his (partner) duties to the maximum advantage of all the partners
2. Should act in a just and faithful manner towards other partner and partners.
3. Should share the losses of the firm equally unless and otherwise agreed upon by all partners.
4. Should indemnify the firm against losses sustained due to his wilful negligence in the business.
5. Must maintain true and correct accounts relating to the firm's business.
6. No partner should make secret profits by way of commission or otherwise from the firm's business.
7. Every partner is bound to keep and render true and proper accounts of the firm to his co-partners.
8. No partner is allowed to assign or transfer his rights and interest in the firm to an outsider without the consent of other partners.

9. A partner is not entitled to claim any remuneration in the conduct of the business of the firm. However, it is usual to allow some remuneration to working partners by specific agreements.

10. A partner must not carry on any business which is similar to or likely to compete with the business of his current partnership firm.

5.8 Dissolution of Partnership Firm

A distinction should be made between the ***'Dissolution of Partnership'*** *and* ***'Dissolution of Firm'***.

a. Dissolution of Partnership

Dissolution of partnership implies the termination of the original partnership agreement or change in contractual relationship among partners. A partnership is dissolved by the insolvency, retirement, incapacity, death, expulsion, etc. of a partner or on the expiry/completion of the term/venture of partnership.

A partnership can be dissolved without dissolving the firm. In dissolution of partnership, the business of the firm does not come to an end. The remaining partners continue the business by entering into a new agreement. On the other hand, dissolution of firm implies dissolution between all the partners. Thus, business of the partnership firm comes to an end. The remaining partners continue the business by entering into a new agreement.

b. Dissolution of firm

Dissolution of firm implies dissolution between all the partners. The business of the partnership firm comes to an end. Its assets are realised and the creditors are paid off. Thus, dissolution of firm always involves dissolution of partnership but the dissolution of partnership does not necessarily mean dissolution of the firm.

A partnership firm may be dissolved in any one of the following ways:

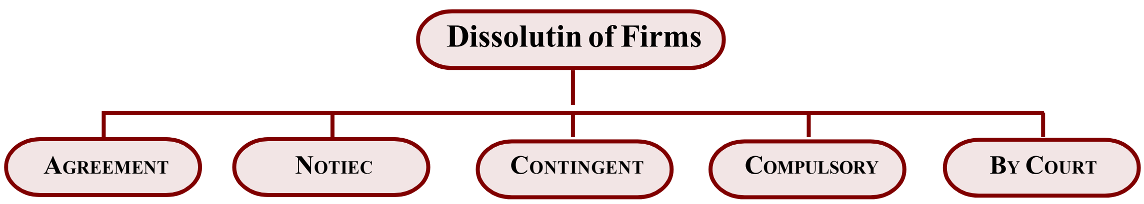


Figure 5.3 : Dissolution of firm

1. **Dissolution by Agreement:** A partnership firm may be dissolved with the mutual consent of all the partners or in accordance with the terms of the agreement.
2. **Dissolution by Notice:** In case of partnership-at-will, a firm may be dissolved, if any partner gives a notice in writing to other partners indicating his intention to dissolve the firm.
3. **Contingent Dissolution:** A firm may be dissolved on the expiry of the term, completion of the venture, death of a partner, adjudication of a partner as insolvent.
4. **Compulsory Dissolution:** A firm stands automatically dissolved if all partners or all but one partner are declared insolvent, or business becomes unlawful.
5. **Dissolution Through Court:** Court may order the dissolution of a firm, when any partner becomes members unsound, permanently incapable of performing his duties, guilty of misconduct, wilfully and persistently commits breach of the partnership agreement, unauthorised transfers the whole of his interest or share in the firm to a third person.

Summary

Partnership firm is an outcome of an agreement between two or more persons (partners) to share the profits and losses among them. In order to overcome the limitations of limited capital, limited managiral ability and extend the size of the business, the viable and feasible option is Partnership form of organisation. The formation of the Partenership is very easy and the capital contribution will also be from among the partners.

The liability of parners unlimited and there is no separate legal entity to this organisation. The partnership firm functions as per the Partnership Deed and according to the rules and regulations laid down in the Partnership Act, 1932. There are different types of partners and each one of them enjoys his own rights and duties. Partnership form of organisations can be dissolved with the mutual consent of the partners, if any partner gives notice in writing to the others for dissolution, expiry of the term of agreement or business, insolvency of firm or in the event of court order.

Questions

I. Essay Type Questions

1. Define Partnership. Discuss its merits and limitations
2. Is registration of Partnership compulsory under the Partnership Act, 1932? Explain the procedure required for registration of a firm.
3. Discuss different types of Partners.
4. What is Partnership Deed and explain its contents.
5. Explain the rights and duties of partners.

II. Short Answer Type Questions

1. Define Partnership and state its important features
2. Discuss the registration procedure of partnership
3. Briefly explain the rights of partners
4. Briefly explain the duties of partners
5. Explain the ways of dissolution of a Partnership Firm.
6. Differentiate dissolution of partnership and dissolution of firm.

III. Very Short Type Questions

1. Partnership Firm
2. Partnership Deed
3. Active Partner
4. Sleeping Partner
5. Partner by Estoppel
6. Partner by Holding out
7. Nomial Partner
8. Partner by Holdingout
9. Dissolution of firm
10. Dissolution of partnership
11. Compulsory dissolution
12. Dissolution by notice.
13. Contingent dissolution
14. Dissolution by agreement

Student Activity

Visit the partnership form of organisation and find out how many types of partners are there and know individual partners, their rights and duties.

Unit - 3

Joint Stock Company

Fundamental Aspects of Joint Stock Company

CHAPTER
6

6.1 Joint Stock Company

Meaning and Definition

Sole proprietorship, Joint-Hindu family and Partnership form of business organisations could not meet the needs of modern industry and commerce because of their limitations like limited resources, unlimited liability etc. The need for another form of organisation free of the above limitations was felt and thus Joint Stock type of company came into existence as it can raise large resources, deploy huge capital, use modern technology, introduce specialisations and run with professionalism.

A Joint Stock Company or simply a company is a voluntary association of persons formed for undertaking some big business activity. It is established by law and can be dissolved by law. The company has a separate legal existence so that even if its members die, the company remains in existence. Its members contribute money for a **common purpose.** The money so contributed constitutes the **capital** of the company. The capital of the company is divided into small units called **shares**. Since members invest their money by purchasing the shares of the company, they are known as **shareholders** and the capital of the company is known as **share capital**.

According to section 2(20) of the Companies Act, 2013 company means a company incorporated under this Act or any previousCompany Law general a "A company is an artifical person created by law, having a separate legal entity with a perpetual succession and a common seal.

L.H. Hancy "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".

Lord Justice Lindley " Joint Stock Company is a voluntary association or organisation of many persons who contribute money or a money's worth to a common stock and employ it in some trade and who share the profit or loss arising there from.

An analysis of the above definitions reveals many distinctive characteristics of a Joint Stock Company. They include

1. Joint Stock Company is an association of many persons
2. It is an artificial person but invisible and intangible
3. It is created by law
4. It has a seperate legal entity.
5. It has a distinctive name.
6. It has a common seal
7. Its liability may be limited
8. It has perpetual succession

6.2 Features

The distinctive features of a company are as follows

1. **An artificial Person Created by Law**

   A company is an artificial person created by law and existing only in contemplation of law. It is intangible and invisible legal person having no body and soul.

2. **Separate Legal Entity**

   A company has an entity (i.e., existence) quite distinct (i.e., different) and independent of the existence of the members who constitute it. In otherwords, a company has a separate legal entity entirely different from that of its members. It can make contracts, purchase and sell goods, employ people and conduct any lawful business in its own name. It can sue and can be sued in the court of law in its own name, ofcourse, through some representative.

3. Formation

The formation of a joint stock company involves preparation of several documents and compliance of several legal requirements before it starts its operation. A company comes into existence only when it is registered under the Indian Companies Act, 2013 or any previous Company Law.

4. Common Seal as a Substitute for Signature

As the company is not a natural person, it cannot sign on its documents. The common seal with the name of the company engraved on it is, therefore, used in place of signature. Generally, the secretary of the company is authorised to keep the seal under his safe custody.

5. Perpetual Existence

A company has perpetual existence unlike a sole trading or a partnership concern. Once a company is formed, it continues for an unlimited period until it is legally dissolved. In otherwords, a company has a pepetual life and the death, lunacy, retirement or insolvency of its members (shareholders) does not affect its existence.

6. Limited Liability of Members

The liability of a member of a company is limited to the extent of the amount of shares he holds. For example, if 'Jeswanth' holds one share of Rs. 10 and has paid Rs. 7 on that share, his liability would be limited only upto Rs. 3. Beyond this, he is not liable to pay anything towards the debts or losses of the company.

7. Transferability of Shares

The members of the company (Public company) are free to transfer or dispose the shares held by them to any persons as and when they like. They do not need the consent of other shareholders to transfer their shares. But in case of private company, some restrictions are imposed for transfering shares.

8. Membership

To form a joint stock company, a minimum of two (2) members are required in case of private limited company and seven (7) members in case of public limited company. The maximum limit is fifty (50) in case of private limited company. There is no maximum limit on the number of members in case of a public limited company. In case of one person company, only one shareholder will act as a member.

9. Democratic Management

Different categories of people from different areas contribute towards the capital of a company. So, it is not possible for them to look after the day-to-day management of the company. They may take part in deciding the general policies of company but the day-to-day affairs of the company are managed by their elected representatives - 'Board of Directors'.

10. Statutory Regulations

A company has to comply with and abide by a number of statutory requirements. A company is governed by the Companies Act and it has to invariably follow the various provisions of the Act. The companies should submit a number of returns to the government and also its accounts have to be audited by a Chartered Accountant.

6.3 Classification of Companies

Companies are of different types. They are classified based on different points of views. A brief description about each of them is as follows.

I. On the Basis of Formation

(i) Chartered Companies

The companies which are established by the Royal charter or special sanction of the Royal Head of the State are called chartered companies. Such companies are granted special privilieges and powers to achieve the defined objectives.

Ex: East India Company, Bank of England etc.s

Such kind of companiess do not exist now a days.

(ii) Statutory Company

A company which is created by a special Act of the Parliament or Assembly of any State is called as Statutory Company. The State Bank of India, Reserve Bank of India, Life Insurance Corporation, Unit Trust of India etc., are examples for Statutory Companies.

(iii) Registered Company

A company which is established through registration with the Registrar of Companies under the Companies Act, 2013 or any previous law is called Registered Company. This type of companies are governed by the above Act but subject to the rules of Memorandum of Association and Articles of

Association of their own. Today most of the companies belongs to this category. Infosys, ITC, WIPRO etc. are the examples of registered companies.

(iv) Government Company

Any company in which not less than 51 per cent of the paid-up share capital is held by the Central Government and or by any State Government or State Governments is called a Government Company. ONGC, NTPC are the example of Govt. Companies.

(v) One Person Company

Section 2(62) of Companies Act 2013 defines a One Person Company as a company that has only one person as are nothing but subscribers to its Memorandum of Association or its Shareholders

II. On the Basis of Public Interest

On the basis of number of members or public interest, companies may be further categorized into (i) Private Company and (ii) Public Company,

(i) Private Company

A private company is a very suitable form for carrying on the business of family and small concerns it is registered under the Companies Act, 2013 or any previous Company Law. According to Section 2(68) of the Companies Act, 2013 a private company is one which has the following features.

(a) The minimum paid up capital is Rs. 1,00,000

(b) The minimum number of members is two

(c) The maximum number of members is two hundred

(d) It is prohibited from issue of shares to the public

(e) It is prohibited from transfer of shares

The private companies have to follow all these conditions noted above. It is compulsory for these companies to write “Private Limited’ after their names. The ownership of these companies is confined only to well-known selected persons. It requires minimum of two persons to start a private limited company. Usually, whenever partnership firms are in need of more money to expand their business, they convert themselves into Private Companies. It may be noted that private companies are exempted from various regulations of the Companies Act. In fact they combine the advantages of both the company and the partnership form of business organisation.

(ii) Public Company

It is suitable form of company for carrying on the business at large scale involving huge amount of capital. According to Section 2(17) of the Companies Act, 2013 a private company is one which has the following features.

(a) The minimum paid up capital is Rs. 5,00,000

(b) The minimum number of members is seven

(c) The maximum number of members is unlimited Such a company must use the word "Ltd" as part of its name.

A public company must write public limited or simply limited after its name. Steel Authority of India Limited, Bajaj Auto Limited, Reliance Industries Limited and Hindustan Lever Limited are the examples of public companies.

III. On the Basis of Liability

On the basis of liability of members, the Companies Act makes provision for the registration of these types of companies namely:

(i) Companies Limited by Shares: A company having the liability of its members limited by the memorandum to the value of shares held by them is called a company limited by shares.

(ii) Companies Limited by Guarantee: This type of company can be defined as a company having the liability of its members limited by its memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up. The amount guaranteed by each member cannot be demanded until the company is wound up. Companies limited by guarantee are very few in their number, as they are non trading companies.

(iii) Unlimited Companies : Unlimited companies are the companies in which the liability of the members is unlimited i.e., the members of these companies can be called upon to pay from their Private assets to satisfy the liabilities of the Company in the event of winding up of the company. The capital of these companies can easily altered i.e., increased or decreased easily by passing a special resolution without the sanction of the court. However, these type of companies today are rarely formed and found.

IV. On the Basis of Control: On the basis of control over the company, the companies may be classified as under :

(i) Holding Company: Where one company controls the management of another company, the controlling company is called 'Holding Company'. For example if company 'A' holds more than 51% of paid up share capital of company 'B', the company 'A' is called as holding company.

(ii) Subsidiary Company : Where one company controls the management of another company such company so controlled is called as subsidiary company. For example if company 'A' holds more than 51% of paid up share capital of company 'B', the company 'B' is called as subsidiary company.

V. On the Basis of Nationality:

(i) Indian Company: A company registered in India having place of business in India is called as Indian company. It may be a private company or a public company.

(ii) Foreign Company: It is a company incorporated outside India and having place of business. The term place of business does not mean agency business in India. It may be noted that where, all the shareholders of a company are

6.4 Distinction Between Private Company and Public Company

Basis of Comparison	Private Company	Public Company
1 Minimum number of members	Two (2) members	Seven (7) members
2 Maximum number of members	200 members	No limit
3 Minimum paid up capital	Rs. One lakh	Rs. Five lakh
4 Identification	Must suffix 'Private Limited' to its name	Must suffix 'Public Limited' to its name
5 Transfer of shares	Members cannot transfer their shares	Members can freely sell their shares to others
6 Public issue of capital	It cannot secure capital from the public	It can secure capital from the public

7	Commencement of business	It can start its business immediately upon its incorporation.	It cannot start its business immediately after its incorporation. It has to obtain a certificate for starting.
8	Board of Directors	Minimum: Two (2) Maximum : No limit	Minimum : Three (3) Maximum : 20 directors
9	Appointment and Retirement of Directors	Single resolution is enough to appoint or retire the directors	Separate resolution is required
10	Managerial remuneration	There are no restrictions on the remuneration of Directors and Managing Directors	There are restrictions

Indian citizens, a company shall be called as foreign company if it is registered outside India.

VI. On the basis of area :

(i) **National company**: Such companies confine their operations within the boundaries of the country in which they are registered.

(ii) **Multi-national company:** Such companies which extend the areas of their operations beyond the country in which they are registered.

6.5 Advantages and Disadvantages

Advantages

The following are the advantages of Joint Stock Company.

1. Limited Liability

Shareholders of a company are liable only to the extent of the face value of shares held by them. Their private property cannot be attached to pay the debts of the company. Thus, the risk is limited and known. This encourages people to invest their money in corporate securities. Thus, company form of organisation contributes to the growth of economy.

2. **Large Financial Resources**

Company form of organisation enables to mobilise huge financial resources because of principles of limited liabilities and diffusion of ownership. It collects funds in the form of shares of small denominations so that people with small means can also buy them. Benefits of limited liability and transferability of shares attract investors.

3. **Continuity of Existence**

A company is an artificial person created by law and possesses independent legal status. It is not affected by the death, insolvency etc., of its members. Thus, it has a perpetual existence.

4. **Benefits of Large-scale Operation**

The joint stock company is the only form of business organisation which can provide capital for large-scale operations. It results in large-scale production consequently lead to increase in efficiency and reduction in the cost of operation. It further opens the scope for expansion.

5. **Liquidity**

The transferability of shares acts as an added incentive to investors. The shares of a public company can be traded easily in the stock exchange. The public can buy shares when they have money. The prospective investors can invest and convert shares into cash whenever they need money.

6. **Professional Management**

Companies, because of their complex nature of activities and large volume of business, require professional managers at every level of their operation. This leads to efficiency in management of their business affairs.

7. **Research and Development**

A company generally invests a lot of money on research and development for improved processes of production, designing and innovating new products, improving quality of product, new ways of training its staff, etc.

8. **Tax Benefits**

Although the companies are required to pay tax at a high rate, in effect, their tax burden is low as they enjoy many tax exemptions under Income Tax Act.

Disadvantages

A joint stock company has following disadvantages:

1. **Too Many Legal Formalities**

   Formation of a company is a time-consuming process and also expensive. Many legal formalities have to be observed and several legal documents have to be prepared and filed. Delay in formation may deprive the business the momentum of an early start.

2. **Lack of Motivation**

   The directors and other officers of a company have little personal involvement in the efficient management of a company. Separation between ownership and control and absence of a direct link between effort and reward may lead to lack of personal interest and incentive. It is difficult to keep personal touch with all the customers and employees. As a result, efficiency of business operations may be low.

3. **Delay in Decisions**

   Redtapism and bureaucratic hurdles do not permit quick decisions and prompt action in company form of organisation. There is little scope for personal initiative and a sense of responsibility. Paid employees like to play safe and tend to shift responsibility. There is lack of flexibility of operations in a company.

4. **Economic Oligarchy**

   The management of company is supposed to be carried on according to the collective will of its members. But in practice, there is rule by a few (Oligarchy). Often directors try to mislead the members and manipulate voting power to maintain and continue their control.

5. **Corrupt Management**

   In a company, there is often danger of fraud and misuse of property by dishonest management. Fake companies may be formed to deprive the investors of their hard-earned money. Unscrupulous people may manipulate annual accounts to show artificial profits or losses for their personal gain.

6. **Excessive Government Control**

   At every stage in the management of a company, there are legal rules and regulations. Several legal provisions have to be followed and reports have to be filed. Such legal interference in day-to-day operations results in lack of secrecy. A lot of time and money are spent in complying with statutory requirements.

7. Unhealthy Speculation

The shares of a public company are dealt in on a stock exchange. The prices of these shares fluctuate depending upon the financial health, dividends, future prospects and reputation of the company. Directors of a company may indulge in speculation on the basis of inside information for their private gain. Company organisation may also lead to concentration of economic power in a few hands.

8. Conflict of Interests

Company is the only form of business wherein a permanent conflict of interests may exist. In a company, conflicts may continue between shareholders and board of directors or between shareholders and creditors or between management and workers.

9. Lack of Secrecy

Under the Companies Act, a company is required to disclose and publish a variety of information on its working. Widespread publicity of affairs makes it almost impossible for the company to retain its business secrets. The accounts of a public company are open for inspection to public.

Summary

In the process of analysing and assessing the different forms of business organisations, it can be noted that company form of organisation plays a vital role and significance in the economy of any country. In this chapter, an attempt is made to discuss the Joint Stock Company covering its meaning, definition, features, advantages and disadvantages, classification of companies and also differences between Public and Private limited companies. In the current day circumstances, many people are prefering public companies because of many advantages associated with the public companies as many benefits are given to them by governments at all levels. Thus, the company form of business organisation has emerged as globally popular and has become an established fact in the contemporary business world.

Questions

I. Essay type Questions

1. What is a joint stock company? What are the features of it?
2. Explain the advantages and disadvantages of a joint stock company.
3. Distinguish between a private company and a public company.
4. List out and briefly explain different types of companies.

II. Short Answer Questions

1. What are the features of a Public Company.
2. What are the features of a Private Company
3. List out the features of Joint Stock Company.
4. What are the statutory regulations regarding membership in a Joint Stock Company?

III. Very Short Answer Questions

1. Joint Stock
2. Government Company.
3. Statuatory Company.
4. Chartered Company.
5. One Person Company
6. Private Company
7. Public Company
8. Company Limited by Guarantee
9. Holding Company
10. Subsidiary Company
11. Foreign Company
12. Multinational Company

Student Activity

Visit a company, and find out that what type of company it is and get information the way how it is beneficial to the society.

Formation of a Joint Stock Company

CHAPTER
7

In the previons chapter, it is stated that a Joint Stock Company is a legal entity. It means, a company is brought into existence by the process of incorporation. There are many legal steps to be completed. This process is known as formation of company. In general terms, formation means establishment of a company by fulfilling all formalities of the Companies Act.

7.1 Steps in formation of a Company

A Joint Stock Company requires a number of legal formalities to be complied with before it is brought into existance. The important steps in the formation of a company are shown in the following chart.

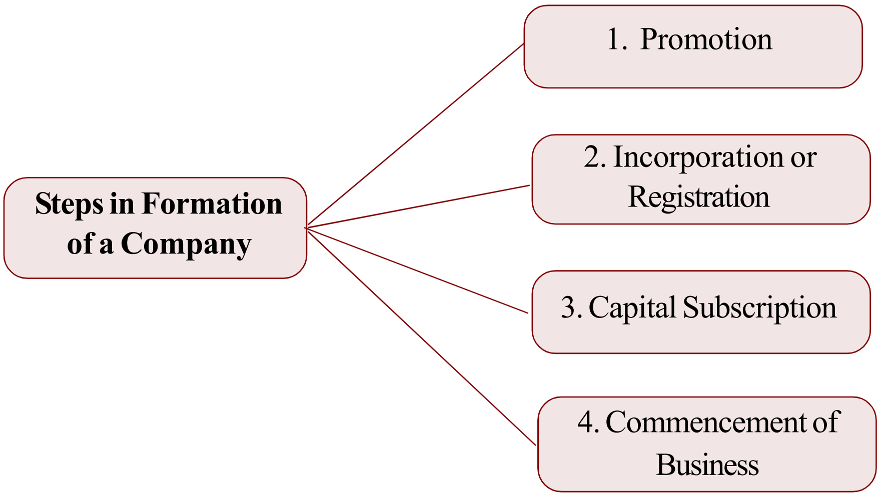


Chart 7.1

From the second step onwards there are legal formalities and they must be complied with. The pre-legal formalities are the promotion. It is the first step in the formation of a company. Of course, it is not a legal step but it is a business proposal.The person who completes this step is called 'promoter'. A brief explanation of each step is given below:

7.2 Promotion

Promotion is the first stage in the formation of a company. It involves identification of a business opportunity or idea, analysis of its prospects, gathering the relevant information and taking steps to implement it. Promotion is considered as putting an idea into practice.

Definition

L.H. Haney "Promotion is the process of organizing and planning the finance of a business enterprise under the corporate form".

Guthmann and Dougal "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 is fully ready to begin operation as a going concern."

To be successful in the promotion, the idea of business must be expsosed and investigated Chart 7.2 gives the different stages of promotion.

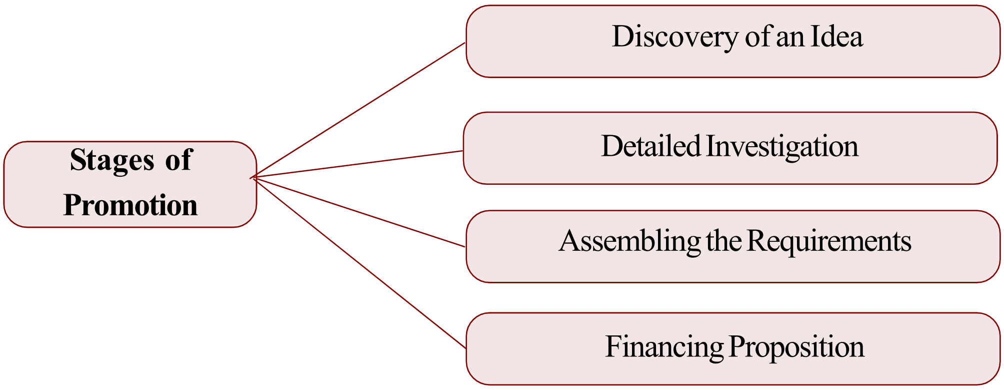


Figure 7.2 : Stages of Promotion

a) Discovery of an Idea

The success of business depends on the selection of a business line. The promoter has to form an idea about the type of business and its prospects. The promoter should analyse the strengths and weaknesses of the proposed idea and develop the idea with the help of technical experts.

b) Detailed Investigation

At this stage various factors relating to the proposed business are to be studied from the practical point of view. The promoter shall estimate the total demand for the product, and then thinks of arranging finance. He also considers the availability of labour, machinery, raw materials and cost structure of the product.

c) Assembling the Requirements

After making sure that the proposition is practical and profitable, the promoter proceeds to assemble the requirements like appointing directors, selecting the place for company, contacts the suppliers of raw materials, purchasing of machinery etc.

d) Financing Proposition

The promoter decides about the capital structure of the company. In this process, he determines how much share capital will be issued, type of shares and debentures to be issued, and the of loans to be borrowed from financial institutions for a longer period.

7.3 Functions of Promoters

A promoter is one who undertakes to form a company. He is instrumental in bringing a company into existence. Promoter may be an individual, a firm, an association of persons, or a company. The promoter takes lead for bringing men, money, material and machinery together for establishing an enterprises. Promoter performs the following functions;

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

7.4 Types of promoters

1. **Professional Promoters**: They are the promoters and specialized in Company promotion. It is their whole time occupation.
2. **Accidental Promoters**: They are the promoters who are not specialists in company formation, but promote their own firms. Such entrepreneurs are known as accidental promoters.
3. **Financial Promoters**: These are the promoters who float new enterprises during favorable conditions in the securities market. He inverts capital and has a sizable company share.
4. **Technical Promoters**: The promoters who promote new enterprises on the basis of their specialized knowledge and training in technical fields are called as Technical promoters.
5. **Institutional Promoters**: These are the promoters who provide technical, managerial, and financial assistance for the promotion of a company.

7.5 Incorporation of a Company or Registration

A company being an artificial person comes into existence only after its registration with the Registrar of Companies. It is the legal process through which an enterprise obtains recognition as a separate legal entity. A Joint stock company, whether private limited or public limited must file all the necessary documents with the Registrar to obtain the Incorporation Certificate. With this Certificate, the company gets a status of legal entity.

Before getting a company registered, a number of steps have to be taken up. They are

1. Application for Approval of Name

For registration of a company, an application is to be submitted to the Registrar of companies of the state and obtain the approval of name. A company may adopt any name which is not prohibited under the Emblems and Names Act, 1950.The Registrar is expected to approve the name within 14 days of the receipt of application. The proposed name must be registered within three months of the approved date.

2. Preparation of Memorandum of Association (MoA)

It is the constitution of company which describes its objects, scope and the relationship with outside world. This document must be carefully drafted, stamped and signed by seven members in case of a public company and two members in case of a private company. As per the new amendment of the act one member is enough to sign on MoA in case of private company/one person company.

3. Preparation of Articles of Association

It is the document which contains rules and regulations relating to the internal management and also the capital structure of the business. A public limited company may not require to file its own Articles of Association. However, it may adopt model clauses prescribed in Table F, Schedule I of the Act. A private company is required to submit its Articles and duly signed by the signatories.

4. Preparation of Other Documents

At the time of incorporation of a company the following documents are to be prepared and submitted to the Registrar of Companies.

a) Consent of the first directors.

b) The Power of Attorney: Promoters should execute a Power of Attorney in favour of one of the promoters or an advocate who is to carry out the formalities required for registration.

c) Notice of Registered Office. When the location of the registered office is finalized, prior to incorporation, the notice of it is to be filed. If not, within 30 days of its registration, it is to be submitted.

d) Particulars of Directors. When a company by its Articles appoints any person to act as Director, Manager, Secretary- their particulars have to be filed within 30 days along with the Memorandum of Association and Articles of Association of the company.

5. Statutory Declaration

A declaration that all the requirements under the Companies Act have been complied within Form no.1 is to be filed with the Registrar.

6. Payment of Registration Fee

In addition to filing with the documents, the prescribed fees has to be paid towards registration of company.

7. Incorporation Certificate

If the Registrar is satisfied with all the statutory requirements stated above are complied with under the Act, issues a certificate called "Certificate of Incorporation". With the receipt of this certificate, the company gets its recognition as a corporate body.

A private company can start its business as soon as it gets the incorporation certificate. But a public company should wait till it gets certificate of commencement of business to start the business.

7.6 Capital Subscription

A public company cannot commence business unless the minimum subscription (Minimum amount of capital required) as stated in the prospectus is subscribed. If a company does not receive 90 per cent of the issue amount from the public as subscription within 120 days, it has to refund the amount to the applicants as per the guidelines of Securities Exchange Board of India (SEBI) within 10 days.

7.7 Commencement of Business

A Public company has to file the following certificates to get the Certificate of Commencement of Business.

a) A declaration that a prospectus or statement in lieu of prospectus has been filed.

b) A declaration that directors have taken up their qualification shares and paid them

c) A declaration that minimum subscription amount has been allotted and collected.

d) A statutory declaration by the Secretary of the company or a Director that all the formalities relating to the commencement of business are duly complied with.

A scrutiny is made by the Registrar with all the documents and issues a "Certificate of Commencement of Business" if he satisfied himself that all the formalities are in order and the legal formalities are completed. The process of company formation comes to an end with the issue of this certificate.

Documents to be prepared for formation of a company :

The important documents to be prepared by a company for its formation are discussed below;

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

7.8 Memorandum of Association

Meaning

The Memorandum of Association is the constitution of the company. It is the charter of the company. It provides the foundation on which the company structure is built. It defines the scope of the company's activities as well as its relation with the outside world. The purpose of the memorandum is to enable the shareholders, creditors, and those who deal with the company to know what is the permitted range of activities of the enterprise.

Definition

Section 2 (56) of the Companies Act, 2013 defines a memorandum as " The Memorandum of Association of a company as originally framed or as altered from time to time in pursuance of any previous company laws or of this Act".

The Memorandum of Association must be signed by at least seven members in case of a public limited company and two members in case of a private limited company. It is the basic document of the company. It cannot be changed easily. So it should be prepared very carefully.

The contents of Memorandum of Association known as clauses are explained below;

Clauses of Memorandum of Association

1. 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. It should not contain the words like King, Queen and name of the Government bodies. The proposed name should not be objectionable under the provisions of Emblems and Names Act 1950. The word "Limited" must be used at the end of the name of a public company, and "Private Limited" is used by a private company.

2. Registered Office or Situation Clause

This clause states the place and address of the registered office of the company. This helps to have correspondence with the company. If the place is not decided at the time of incorporation, it can be intimated to the Registrar within 30 days from the date of incorporation or commencement of business whichever is earlier.

3. Objects Clause

This Clause defines the sphere of activities of the company. It also determines the powers of the company. This clause may be considered as the core of

Memorandum of Association because it sets out the objects for which a company is formed. This caluse contains (a) Main objects (b) Other objects. This clause offers protection to the shareholders and creditors by ensuring that the funds are not going to be risked.

4. **Liability Clause**

This Clause contains the nature of liability of its members. It states that the liability of the members is limited to the value of shares held by them. It means that the members are liable to pay only the unpaid balance of their shares and not further else.

5. **Capital Clause**

This Clause contains the capital structure (total capital) of the company. The division of capital into equity shares, preference shares, and the no of shares in each category, and their value should be given. It is also mentioned that any type of shareholders have some special rights and privileges.

6. **Association Clause**

This clause contains the names of the signatories to the Memorandum of Association. The full addresses and occupations of subscribers and witnesses are also given. The subscribers declare that they agree to incorporate the company and agree to take the shares stated against their names.

7.9 Articles of Association

Meaning

The rules and regulations framed for the internal management of the company, which are set out in a document is named as **Articles of Association**. It gives the bye-laws which govern the conduct of the company. It also helps in achieving the objectives specified in Memorandum of Association. The Articles play a very important role in the affairs of the company. It is a supplementary document to the Memorandum of Association.

The Articles must be printed, divided into paragraphs, numbered consecutively, stamped adequately, and signed by each subscriber to the Memorandum of Association. It is duly witnessed and filed along with the Memorandum of Association.

Definition

According to Section 2 (5) of the Companies Act "Articles of Association of the company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act". The articles of a company shall contain the regulations for management of the company.

The private companies limited by shares, companies limited by guarantee and unlimited companies must have their Articles of Association. A Public company limited by shares may or may not have its own Articles. As per section 26 of Companies Act, it is not obligatory on the part of public limited company to prepare and register the Articles of Association. It can follow model set of Articles given in Tables F, G, H, I and J in Schedule I of the Act. The Articles of Association can be altered by passing a special resolution. Each subscriber to the memorandum must sign the articles in the presence of at least one witness.

The Contents of Articles of Association:

The Articles of Association contains the following details.

1. Procedure of issuing share capital- The amount of share capital issued, types of shares, number of shares, calls on shares, rights and privileges of different categories of shareholders must be mentioned in the Articles of Association.
2. Procedure for transfer and forfeiture of shares
3. Procedure for issue of debentures and stocks
4. Powers to alter as well as reduce share capital and its procedure for alteration
5. The appointment of the directors, their powers, duties, and remuneration
6. The appointment of the managing director
7. Provisions regarding conducting the General meetings, special meetings, voting, proxies, resolutions etc,.
8. Provisions relating to dividends and reserves.
9. Rules for preliminary contracts
10. Provisions regarding the use of Common Seal.
11. Preparation of Accounts and Audit, and method of appropriation of profits.

12. Maintenance of Bank accounts
13. Procedure for winding up the company
14. Other rules and regulations of the company.

Differences between Memorandum of Association and Articles of Association

Aspects	Memorandum of Association (MOA)	Articles of Association (AOA)
Scope	It is a constitution of the company. The company works in the framework given in the memorandum	The articles contain bye-laws for the day-to-day working of the company as set out in the MOA.
Need	MoA must be prepared by all the companies and filed with the Registrar of Companies.	Public companies may not have their own articles. They can adopt Tables, F, G, H, I and J of Schedule I as its articles.
Relationship	It defines the relationship between the company and outside world.	It defines the relation between the company and the members among themselves.
Alteration	It cannot be changed easily.	It can be altered easily by the special resolution of shareholders.
Provisions	It is subordinate only to the Act. The company works with in the legal provisions of MOA.	It is subordinate to the memorandum and Companies Act and cannot contain anything contrary to both.
Legal Effects	Any act of the company beyond the scope of memorandum will become void	Anything is done beyond the scope of the articles will not be void and it can be ratified by passing a special resolution

7.10 Prospectus

Meaning

Prospectus is an invitation to the public to subscribe to the shares and debentures of a public company. This brings to the notice of the public that a new company has been formed. After incorporation of a company promoters may issue the prospects for raising required finance.

A public company invites the people to offer to purchase the shares and debentures through an advertisement. Such an advertisement or notice containing detailed information about the company is known as Prospectus.

A private company cannot issue prospectus to secure its capital, because they are strictly prohibited from inviting the public to subscribe to their shares or accepting any deposits.

Definition

Section 2 (70) of the Companies Act, 2013 defines the Prospectus as "any document described or issued as Prospectus and includes any notice, circular, advertisement or other documents, inviting deposits from the public for the subscription or purchase of any shares in, or debentures of a body corporate"

Every prospectus contains an application form on which an intending investor can apply for the purchase of shares or debentures. A public company must get minimum subscription within in 120 days from the date of issue of prospectus. If it fails to obtain minimum amount of capital required from the members of the public within the specified period, then it has to return the amount already collected.

Contents of Prospectus

Every prospectus should disclose the matter as specified in Part-I of Schedule-II of the Companies Act. Some of the contents which every prospectus must include are;

1. Name and full address of the company
2. The particulars of the signatories to the Memorandum of Association and the number of shares taken up by them.
3. Name, addresses, and occupations of members of the Board of Directors

4. The minimum subscription amount fixed by the promoters.
5. The details of property acquired if any.
6. The time of opening of the subscription list.
7. The capital structure of the company and particulars of issue.
8. The amount payable on application, allotment and calls.
9. Basis for the issue price
10. The particulars of preferential treatment given to any person for subscribing shares or debentures.
11. The addresses of the underwriters if any.
12. Particulars about reserves and surpluses
13. The amount of preliminary expenses.
14. The name and address of Auditor.
15. Particulars regarding voting rights at the meetings of the company.
16. Management perception of risk factors.
17. Disclosure of investors grievances and redressal system.

Legal Requirements for Prospectus

In order to protect the interests of investors, the Companies Act lays down the following regulations relating to the issue of prospectus. They are;

a) Prospectus must be dated.

b) It must be signed by every person who is named as director.

c) It must be issued within 90 days of its registration either by newspaper advertisement or otherwise.

d) It must not be issued unless a copy thereof has been filed with the Registrar on or before the date of its publication.

e) A prospectus must be in writing. An oral invitation (through TV. or film) to subscribe for shares and debentures of a company or deposits is not a prospectus.

f) Any information given in the prospectus must be true. All relevant facts should be accurately stated and relevant information should be not omitted. A prospectus must not contain any misstatements which may influence and mislead the mind of the reader.

Mis-statements in Prospectus:

If there are any misstatements or misrepresentation in prospectus, it gives rise to impose Civil or Criminal liability on (a) The company, (b) Promoters and Directors, (c) Expert who drafted the Prospectus. The Companies Act, 2013 makes these persons liable for punishment.

a) **Civil Liability Section (35) :** The persons responsible for misstatements or untrue statements of prospectus are liable to Pay Compensation to the persons, who subscribed the shares and debentures relying on such false information in the prospectus. The person found liable for making false statements may also be liable for penality extending upto one half of the amount of fraud committed.

b) **Criminal Liability Section (34) :** The persons responsible for misstatements or untrue statements of prospectus are liable for punishment which may extend upto five years of **imprisonment** and fine extending upto three times the value of the securities issued by the company or the fraud committed, whichever is higher.

Statement-in-lieu of Prospectus

The statement-in-lieu of prospectus is a substitute of prospectus. In case a public company raises its capital through some other means (privately) there is no need to issue prospectus, but a "Statement in lieu of prospectus" must be filed with the Registrar atleast three days before the first allotment of shares. It must be duly signed by all the directors. This statement is drafted strictly in accordance with the particulars set out in Schedule III of the Act.

7.11 Minimum Subscription

The minimum amount of capital to be collected by a public company before its allotment of shares is known as **'minimum subscription'**.

A Public company cannot commence business unless a minimum subscription as stated in the prospectus has been subscribed. The amount of minimum subscription is fixed by taking into account the following requirements.

1. Amount required for the purchase of property
2. Amount needed for payment of preliminary expenses
3. Amount required for working capital
4. Amount required for any other expenditure for the formation of company.

7.12 Certificate of Commencement of Business

A public limited company cannot commence its business unless it received a certificate of business commencement. This certificate is not compulsory for private limited company. It means private company call commence its business without the certificate of Business commencement. The Registrar of Companies issue this certificate only when all the legal documents are submitted. Further, the Registrar issued this certificate only on the confirmation of collection minimum subscription.

Summary

In this chapter, an attempt is made to explain the detailed procedures adopted for the formation of a company. Company formation involves promotion, incorporation or registration, capital subscription and commencement of business. Further, the chapter also highlights the raising of capital i.e., the shares, and debentures through prospectus.

The important documents required to be prepared for incorporation includes Memorandum of Association, Articles of Association, consent of Directors, Declaration by company etc. For the commencement of business of a public company the important documents required to be prepared in addition to the above documents include prospectus or statement in lieu of prospectus, declaration of directors and statuatory declaration of Secretary.

Questions

I. Essay type Questions

1. Discuss the procedure to form a company.
2. Describe various steps involved in promoting a company.
3. Explain the process involved in Incorporation of a company.
4. What is Memorandum of Association ? Explain its clauses.
5. What is Articles of Association and also explain its contents.
6. What is prospectus? Explain the contents of prospectus.

II. Short Answer Questions

1. What are different types of promoters?
2. Discuss the differences between Memorandum of Association and Articles of Association.
3. Explain the functions of promoters.
4. What documents are required to obtain certificate of Commencement of Business?
5. What is the liability for mis - statement in prospectus ?

III. Very Short Answer Questions

1. Promotion.
2. MOA.
3. Minimum Subscription
4. Statement in lieu of Prospectus
5. Criminal liability for misstatements in Prospectus.
6. Certificate of Commencement of Business.
7. Financial promoters.
8. Incorporation Certificate.

Student Activitsy

Visit a company, collect information about how a company is formed and examine the different documents to be prepared for the formation of a company.

UNIT - IV

Sources of Business Finance

Chapter 8: Basics of Business Finance

Chapter 9: Sources of Finance

Basics of Business Finance

CHAPTER

8

Introduction

This chapter provides an overview of the various sources from where funds can be procured for starting and running a business. It discusses the merits and limitations of various sources and also points out the factors that determine the choice of a suitable source of business finance..

8.1 Meaning of Business Finance

The requirement of funds by business firm to accomplish its various activities is called 'business finance'.

Finance is considered as the life blood of any organization. The success of an industry depends on the availability of adequate finance. To promote and operate the proposed enterprise economically and efficiently, adequate finance is necessary. Finance is a vital functional area of business. It deals with procurement of funds and their effective utilisation. Finance is also labeled as capital of a company. A business fundamentally requires identifying its sources of finance from where it can procure funds. As soon as an entrepreneur starts the business, the need for business finance emerges.

Definitions

Howard and Upton "Business finance involves a set of administrative functions in an organization which relate with the arrangement of cash and credit so that the organization may have the means to carry out its objectives as satisfactorily as possible."

B.O. Wheeler. "Finance is that business activity which is concerned with the acquisition and conservation of capital funds in meeting the financial needs and overall objectives of a business enterprise."

8.2 Nature of Business Finance

The financial needs of a business organization can be categorized as follows:

(A) Fixed Capital Requirements

In order to start business, funds are required to purchase fixed assets like***land and building***, ***plant and machinery***, and ***furniture and fixtures.*** This is known as fixed capital requirements of the business enterprise. The funds required in fixed assets remain invested in the business for a***long period of time***. Different business units need varying amount of fixed capital depending on various factors such as ***the nature of business***, etc. A trading concern for example, may require small amount of fixed capital as compared to a manufacturing concern. Likewise, the need for fixed capital investment would be greater for a large business enterprise, as compared to that of a small enterprise

B) Working Capital Requirements

The financial requirements of a business enterprise do not end with the procurement of fixed assets. No matter how small or large a business is, it needs funds for its day-to-day operations. This is known as ***working capital*** of an enterprise, which is used for holding current assets such as ***Stock of material***, ***bills receivables*** and for meeting expenses like ***salaries, wages, taxes, and rent.***

The amount of working capital required varies from one business enterprises to another depending on various factors. For example, A business unit selling goods on credit, or having a slow sales turnover, would require more working capital as compared to a concern selling its goods and services on cash basis or having a high turnover.

The requirement for fixed and working capital increases with the growth and expansion of business. At times, additional funds are required for upgrading the technology employed so that the cost of production or operations can be reduced. Similarly, larger funds may be required for building higher inventories for the festive season or to meet current debts or expand the business or to shift to a new location. It is, therefore, important to evaluate the different sources from where funds can be raised.

8.3 Need for and Significance of Business Finance

Business needs finance mainly for acquiring various types of assets and to meet various expenses on day to day basis. There are also many other reasons for the requirment of business finance. The significance and need of business finance is explained below.

For establishing a new business:

1. **To meet fixed capital requirement of business**: To purchase fixed assets like land and building, plant and machinery, furniture and fixtures, etc., business requires finance.
2. **To meet working capital requirements**: Working Capital is used for holding current assets such as stock of material, payment of wages, transportation expenses, etc.
3. **For growth and expansion:** For growth and expansion activities, a business requires finance. It may be required to increase production, to install more machines, to set up a R&D centre, etc.
4. **For diversification**: Business finance is needed to start any new activity in business. For example: ITC dealing with tobacco started ITC Kakatiya (hotels), Vivel (shampoos, and cosmetics), Classmate (note books and stationery) etc. Entering into new businesses and new lines of activities is known as diversification. Similarly main enterprises keep on grabbing opportunities to start producing products of different segments.
5. **For survival**: To carry out the various business operations in continuity, business finance is needed. Without the required finance, organizations cannot survive for long.
6. **To meet Liabilities**: To meet liabilities of business, be it long-term or short, a business requires sufficient finance, e.g., for payment of loan installments, creditors, etc.

7. **For payment of expenses**: For paying salaries, wages, taxes, advertisements and rent, finance is needed.

Therefore, to execute the various plans of the business, finance is needed.

8.4 Classification of Sources of Funds

In case of ***Proprietary*** and ***Partnership*** concerns, the funds may be raised either from personal sources or borrowings from indigenous bankers or financial institutions etc,. In case of company form of business organisation, the different sources of business finance are available in the market. The sources of funds can be categorized using different basis viz., on the basis of the period, on the basis of the ownership and on the basis of source of generation. A brief explanation of these classifications and the sources is given below.

A. On the Basis of Period

On the basis of period, sources of funds can be categorized into three ways. The arey (1) Long-term finance, (2) Medium-term finance and (3) Short-term finance.

(1) *Long-term finance*

The long-term sources fulfill the financial requirements of an enterprise for a period exceeding five years and include sources such as

- Shares and debentures
- Long-term borrowings, and
- Loans from financial institutions

Such financing is generally required for the acquisition of fixed assets such as land and buildings, equipment, plant and machinery etc.

(2) *Medium-term finance*

Where the funds are required for a period of more than one year but less than five years, medium-term sources of finance are used. These sources include

- borrowings from commercial banks,
- public deposits,
- lease financing and
- loans from financial institutions.

(3) *Short-term sources of finance*

Short-term funds are those which are required for short duration i.e. a period not exceeding one year. Trade credit, loans from commercial banks (bank credit), indigenous Bankers, installment credit, advances, bank over drafts, cash credits and commercial papers are some of the examples of short –term sources.

B. On the basis of Ownership

On the basis of ownership, the sources can be classified into '***owners' funds***' and '***borrowed funds'***. Owners' funds means funds that are ***provided by the owners of an enterpris****e*, which may be a sole trader or partners or shareholders of a company. Apart from capital, it also includes profits reinvested in the business. The owner's capital remains invested in the business for a longer duration and is not required to be refunded during the life period of the business. Such capital forms the basis on which owners acquire their right of control of management. ***Issue of equity shares*** and ***retained earnings*** are the two important sources from where owner's funds can be obtained. **'Borrowed funds'** on the other hand, refer to the funds raised through ***loans or borrowings***. The sources for raising borrowed funds include loans from commercial banks, loans from financial institutions, issue of debentures, public deposits and trade credit.

C. On the basis of Generation

Sources of Finances can be generated from internal (within the organization) or from external sources. ***Internal sources of funds*** are those that are generated from within the business. Such as ploughing back of profits, retained earnings, collection of receivables, disposing of surplus inventories and depreciation of funds etc,. ***External sources of funds*** include those sources that lie outside an organization, such as shares, debentures, public deposits, borrowing from commercial banks and financial institutions, suppliers, lenders, and investors.

Classification of Sources of Finance

- On the Basis of Period
  - Long term
    1. Equity shares
    2. Retained earnings
    3. Preference shares
    4. Loans from banks
    5. Loans from financial Institutions
  - Short term
    1. Trade credit
    2. Factoring
    3. Banks
    4. Commercial paper
  - Medium term
    1. Loans from Banks
    2. Public deposits
    3. Loans from financial institutions
    4. Lease financing
- On the Basis of Ownership
  - Onwers funds
    1. Equity shares
    2. Retained earnings
  - Borrowed funds
    1. Debentures
    2. Loans from Banks
    3. Loans from Financial institutions
    4. Public financing
    5. Lease financing
    6. Commercial paper
- On the Basis of Source of Generation
  - Onwers funds
    1. Equity shares
    2. Retained earnings
    3. Preference shares
  - Borrowed funds
    1. Loans from banks
    2. Loans from financial institutions
    3. Public deposits
    4. Debentures
    5. Lease financing
    6. Commercial paper
    7. Trade credit
    8. Factoring

8.5 Factors Determining the Choice of Sources of Finances

Financial needs of a business are of different types — long term, short term, fixed and fluctuating. Therefore, business firms resort to different types of sources for raising funds. The choice of selecting a better source of finance depends on the following factors;

(i) Cost

There are two types of cost viz., the cost of procurement of funds and cost of utilizing the funds. Both these costs should be taken into account while deciding about the source of funds that will be used by an organisation.

(ii) Financial strength and stability of operations

The financial strength of a business is also a key determinant. In the choice of source of funds for business should be in a sound financial position so as to be able to repay the principal amount and interest on the borrowed amount.

(iii)Form of organisation and legal status

The form of business organisation and status influences the choice of a source for raising money. A partnership firm, for example, cannot raise money by issue of equity shares as these can be issued only by a joint stock company.

(iv) Purpose and time period

Business should plan according to the time period for which the funds are required. A short-term need for example can be met through borrowing funds at low rate of interest, through trade credit, commercial paper, etc. For long term finance, sources such as issue of shares and debentures are more appropriate.

(v) Risk profile

Business should evaluate each of the source of finance in terms of the risk involved. For example, there is a least risk in equity as the share capital has to be repaid only at the time of winding up and dividends need not be paid if no profits are available. A loan on the other hand, has a repayment schedule for both the principal and the interest. The interest is required to be paid irrespective of the firm earning a profit or incurring a loss.

vi) Control

A particular source of fund may affect the control and power of the owners on the management of a firm. Issue of equity shares may mean dilution of the control. For example, as equity share holders enjoy voting rights, financial institutions may take control of the assets or impose conditions as part of the loan agreement. Thus, business firm should choose a source keeping in mind the extent to which they are willing to share their control over business.

(vii) Effect on creditworthiness

The dependence of business on certain sources may affect its creditworthiness in the market. For example, issue of secured debentures may affect the interest of unsecured creditors of the company and may adversely affect their willingness to extend further loans as credit to the company.

(viii) Flexibility and ease

Another aspect affecting the choice of a source of finance is the flexibility and ease of obtaining funds. Restrictive provisions, detailed investigation and documentation in case of borrowings from banks and financial institutions for example may be the reason that business organisations may not prefer it, if other options are readily available.

(ix) Tax benefits

Various sources may also be weighed in terms of their tax benefits. For example, while the dividend on preference shares is not tax deductible, interest paid on debentures and loan is tax deductible and may, therefore, be preferred by organisations seeking tax advantage.

Summary

Finance required by business to establish and run its operations are known as business finance. No business can function without adequate amount of funds for undertaking various activities. The funds are required for purchasing fixed assets (fixed capital requirement), for running day-to-day operations (working capital requirement), and for undertaking growth and expansion plans in a business organisation.

Various sources of funds available to a business can be classified according to three major basis, which are (i) time period (long, medium and short term), (ii) ownership (owner's funds and borrowed funds), and (iii) source of generation (internal sources and external sources).

The sources that provide funds for a period exceeding five years are called long-term sources. The sources that fulfill the financial requirements for the period of more than one year but not exceeding five years are called medium term sources and the sources that provide funds for a period not exceeding one year are termed as short term sources.

Owner's funds refer to the funds that are provided by the owners of an enterprise. Borrowed capital, on the other hand, refers to the funds that are generated through loans or borrowings from other individuals or institutions. Internal sources of capital are those sources that are generated within the business say through ploughing back of profits.

External sources of capital, on the other hand are those that are outside the business such as finance provided by suppliers, lenders, and investors.

An effective appraisal of various sources must be instituted by the business to achieve its main objectives. The selection of a source of business finance depends on factors such as cost, financial strength, risk profile, tax benefits and flexibility of obtaining funds. These factors should be analyzed together while making the decision for the choice of an appropriate source of funds.

Questions

I. Essay Type Questions

1. What is business finance? Explain its need and significance in the business organizations.
2. What are the various factors that determine the selection of sources of finance?

II. Short Answer Type Questions

1. What are the various types of capital required for business enterprises?
2. Explain the classification of sources of finance.

III. Very Short answer Questions

1. Business finance
2. Fixed Capital
3. Working Capital
4. Long - term finance
5. Short - term finance
6. Internal sources of finance
7. External sources of finance
8. Borrowed Funds

Student Activity

Visit a local business organization and collect the information relating to the fixed and working capital required to run the business effectively.

Sources of Finance

CHAPTER
9

Introduction

In the previous chapter, sources of Business finance-I, we have learnt, the meaning, nature, significance and classification of vairous sources of finance and factors that determine the selection of various sources of finance.

In this chapter sources of business finance - II, we are going to learn Institutional sources of finance, Non-institutional sources of finance and international sources of finance. Various sources of business finance are broadly classified into three. They are

Classification of Sources of Finance

1. Non-Institutional Sources of Finance
2. Institutional Sources of Finance
3. International Sources of Finance

9.1 Non-Institutional sources of Finance

A business can raise funds from various sources. Each of the sources has unique characteristics, which must be properly understood so that the best available source of raising funds can be identified. There is not a single best source of funds for all organisations. Depending on the situation, purpose, cost and associated risk, a choice may be made about the source to be used. For example, if a business wants to raise funds for meeting fixed capital requirements, long term funds may be required which can be raised in the form of owned funds or borrowed funds. Similarly, if the purpose is to meet the day-to-day requirements of business, the short term sources may be tapped. A brief description of various sources, along with their advantages and limitations is given below.

Classification of Non - institutional Sources of Finance

On the basis of period, sources of sources can be categorized into three. They are

1. Long term sources (above 5 years)
2. Medium term sources (above 1 year and below)
3. Short-term sources (below one year)

On the Basis of Period

A. Long-Term Sources	B. Medium –Term Sources	C. Short-term
1. Equity Shares	1. Public Deposits	1 Bank Credit
2. Preference Shares	2. Loans from Banks	2 Trade Credit
3. Retained Earnings	3. Lease Financing	3 Installment Credit
4. Debentures		4 Advances
		5 Commercial Papers

A. Long Term Sources of Finance

1. Issue of Shares

The capital obtained by issue of shares is known as '***share capital***'. The capital of a company is divided into small units called '***shares***'. Each share has its nominal value. For example, a company can issue 1,00,000 shares of Rs. 10 each for a total value of Rs. 10,00,000. The person holding the share is known as '***shareholder***'. There are two types of shares normally issued by a company. These are 'equity shares' and 'preference shares'. The money raised by issue of equity shares is called ***'equity share capital',*** while the money raised by issue of preference shares is called '***preference share capital***'.

(a) Equity Shares

Equity shares are the most important source of raising long term capital by a company. Equity shares, also known as ordinary shares represent the ownership of a company and thus the capital raised by issue of such shares is known as ***ownership capital or owner's funds***. Equity share capital is a prerequisite to the creation of a company. ***Equity shareholders*** do not get a fixed dividend but are paid on the basis of earnings by the company. They are referred to as 'residual owners' since they receive what is left after all other claims on the company's income and assets have been settled. They enjoy the reward as well as bear the risk of ownership. Their liability, however, is limited to the extent of capital contributed by them in the company. These shareholders have a right to participate in the management of a company.

Merits

The important merits of raising funds through issuing equity shares are given below:

1. Equity shares do not create any obligation to pay a fixed rate of dividend.
2. Equity shares can be issued without creating any charge over the assets of the company.
3. It is a permanent source of capital and the company need not repay it except under liquidation.
4. Equity shareholders are the real owners of the company who have the voting rights.

5. In case of profits, equity shareholders are the real gainers by way of increased dividends and appreciation in the value of shares.

Limitations

The major limitations of raising funds through issue of equity shares are as follows:

1. Investors who want steady income may not prefer equity shares as equity shares get fluctuating returns;
2. The cost of equity shares is generally more as compared to the cost of raising funds through other sources;
3. Issue of additional equity shares dilutes the voting power, and earnings of existing equity shareholders;
4. More legal formalities and procedural delays are involved while raising funds through issue of equity shares.

II. Preference Shares

The capital raised by issue of preference shares is called '***preference share capital***'. The preference shareholders enjoy preferential position over equity shareholders in two ways:

- ❖ Receiving a fixed rate of 'dividend', out of the net profits of the company, before any dividend is declared for equity shareholders; and
- ❖ Receiving their capital after the claims of the company's creditors have been settled, at the time of liquidation.

In other words, as compared to the equity shareholders, the preference shareholders have a preferential claim over dividend and repayment of capital. Preference shares resemble debentures as they bear ***fixed rate of return***. Also as the dividend is payable only at the discretion of the directors and only out of profit after tax, to that extent, these resemble equity shares. Thus, preference shares have some characteristics of both equity shares and debentures. Preference shareholders generally do not enjoy any voting rights. A company can issue different types of preference shares.

Types of Preference Shares

(a) Cumulative Preference Shares: Under Cumulative preference shares the dividend is accumulated if it is unpaid during a year, as cumulative preference shareholders carry the right to accumulate unpaid dividend in the future years.

(b) Non-cumulative Preference Shares: Under non-cumulative preference shares, the dividend does not accumulate.

(c) Participating Preference Shares: Participating preference shares are those preference shares which have a right to participate in the company's surplus after paying dividend to equity shareholders and preference shareholders.

(d) Non-participating Preference Shares: The holders of such shares do not enjoy right of participating in the profit of the company.

(e) Convertible Preference Shares: These shares can be converted into equity shares within a specific period of time.

(f) Non-convertible Preference Shares: Non-convertible preference shares cannot be converted into equity shares.

(g) Redeemable Preference Shares: Redeemable preference shares are those shares, the investments on which are to be paid back to their respective holders after the completion of a certain time period.

(h) Irredeemable Preference Shares: Irredeemable preference shares do not carry any fixed period of repayment.

Merits

The merits of preference shares are given as under:

1. Preference shares provide reasonably steady income in the form of fixed rate of return and safety of investment;
2. Preference shares are useful for those investors who want to get fixed rate of return with comparatively low risk;
3. It is a superior security over equity shares
4. Payment of fixed rate of dividend to preference shares may enable a company to declare higher rates of dividend for the equity shareholders in good times;
5. Preference shareholders have a preferential right of repayment over equity shareholders in the event of liquidation of a company;

6. Preference capital does not create any sort of charge against the assets of a company.

Limitations

The major limitations of preference shares as a source of business finance are as follows:

1. Preference shares are not suitable for those investors who are willing to take risk and are interested in higher returns;
2. Preference capital dilutes the claims of equity shareholders over assets of the company;
3. The rate of dividend on preference shares is generally higher than the rate of interest on debentures
4. As the dividend on these shares is to be paid only when the company earns profit, there is no assured return for the investors. Thus, these shares may not be very attractive to the investors;

Difference between Preference shares and Equity Shares

Basis of Difference	Equity Shares	Preference Shares
Choice of issues of these shares	The issue of these shares is compulsory.	The issue of these shares is not compulsory.
Payment of dividend	Dividend is paid after paying dividends on preference shares.	Dividend is paid before paying dividends on equity shares.
Rate of dividend	Rate of dividend is not fixed and it is recommended by the Board of Directors of the company.	Rate of dividend is prefixed and pre communicated.
Return of capital	In case of winding up, capital is refunded after the payment of preference share capital.	In case of winding up, capital is repaid before the payment of equity share capital.

Voting rights	Equity shareholders are the real owners of the company who have the voting rights.	Do not have any voting rights.
Risk profile	It is high risky as compared preference shares.	It is less risky as compared to equity shares.
Speculation	Scope for speculation	No scope for speculation.
Bonus shares	Bonus shares are offered to equity shareholders.	Bonus shares are not offered to preference shareholders.

III. Retained Earnings

A company generally does not distribute all its earnings amongst the shareholders as dividends. A portion of the net earnings may be retained in the business for use in the future. This is known as 'retained earnings'. It is a source of internal financing or self financing or 'ploughing back of profits'. However, the profit available for ploughing back of profits in an organisation depends on many factors like net profits, dividend policy and age of the organization.

Merits

The merits of retained earning as a source of finance are as follows:

1. Retained earnings is a permanent source of funds available to an organisation;
2. It does not involve any explicit cost in the form of interest, dividend or floatation cost,
3. As the funds are generated internally, there is a greater degree of operational freedom and flexibility;
4. It enhances the capacity of the business firm to absorb unexpected losses;
5. It may lead to increase in the market price of the equity shares of a company.

Limitations

1. Excessive ploughing back may cause dissatisfaction amongst the shareholders as they would get lower dividends;
2. It is an uncertain source of funds as the profits of business are fluctuating;
3. The opportunity cost associated with these funds is not recognized by many firms. This may lead to sub-optimal use

IV. Debentures

'Debentures' are an important instrument for raising long term debt capital. A company can raise funds through issue of debentures. It bears a fixed rate of interest. The debenture issued by a company is an acknowledgment that the company has borrowed a certain amount of money, which it promises to repay on a future date. 'Debenture holders' are, therefore, termed as 'creditors of the company'.

Debenture holders are paid a fixed stated amount of interest at specified intervals say six months or one year. Public issue of debentures requires that the issue be rated by a credit rating agency like CRISIL (Credit Rating and Information Services of India Ltd.) on aspects like track record of the company, its profitability, debt servicing capacity, credit worthiness and the perceived risk of lending. A company can issue different types of debentures. Issue of Zero Interest Debentures (ZID) which, do not carry any explicit rate of interest has also become popular in recent years. The difference between the face value of the debenture and its purchase price is the return to the investor.

Types of Debentures

Debentures may be of various types. Some important types of debentures are as follows:

(a) Mortgage Debentures: They are also known as 'secured debentures', i.e., the payment of interest and principal is secured by some charge on any part or the whole of the company.

(b) Simple Debentures: These debentures have no charge on the assets of the company. They are also known as naked or unsecured debentures. They are not secured by any charge or security on any asset of the company.

(c) **Redeemable Debentures:** Those debentures which are issued for a particular fixed time period and after expiry of that period the principal amount is returned. For example: 5 years, 10 yrs, 15 yrs maturity period, after that the amount of debenture is paid back to their holders.

(d) **Irredeemable Debentures:** They are to be paid back at the time of winding up of the company. They are not refundable, i.e., perpetual in nature. A company can, however, redeem such debentures whenever at deems fit.

(e) **Registered Debentures:** The names of the holders are recorded in the books of the company. If such debentures are transferred, the name of the transferee is entered in the register and the name of the original holders is cancelled.

(f) **Bearer Debentures:** The debentures which are not recorded in the register of debenture holders are known as bearer debentures. These debentures are transferable by mere delivery.

(g) **Convertible Debentures:** They carry the option of getting a part or the full value of their investments converted into equity shares on a fixed date.

(h) **Non-convertible Debentures:** They do not enjoy any such right to get themselves converted into equity shares.

Merits

The merits of raising funds through debentures are given below;

1. Debentures are preferred by investors who want fixed income at lesser risk;
2. Debentures are fixed charge funds and do not participate in profits of the company;
3. The issue of debentures is suitable in the situation when the sales and earnings are relatively stable;
4. As debentures do not carry voting rights, financing through debentures does not dilute control of equity shareholders on management.
5. Financing through debentures is less costly as compared to cost of reference or equity capital as the interest payment on debentures is tax deductible

Limitations

1. As fixed charge instruments, debentures put a permanent burden on the earnings of a company. There is a greater risk when earnings of the company fluctuate;
2. In case of redeemable debentures, the company has to make provisions for repayment on the specified date, even during periods of financial difficulty;
3. Each company has certain borrowing capacity. With the issue of debentures, the capacity of a company to further borrow funds reduces.

Distinction between Shares and Debentures

Shares	Debentures
A share is a part of owned capital.	A debenture is an acknowledge of a debt.
Shareholders are paid dividend on the shares held by them.	Debentureholders are paid interest on debentures.
The rate of dividend depends upon the amount divisible profits and the policy of the Board of Directors.	A fixed rate of interest is paid on debentures irrespective of profits or loss.
Shareholders have voting rights. They have control over the management of the company.	Debentureholders are only creditors of the company.
Shares are not redeemable (with the exception of redeemable preference shares) during the life of the company.	Debentures are redeemed after certain period.
At the time of liquidation of the company, share capital is payable after meeting all outside liabilities.	Debentures are payable in priority over share capital..

B. Medium- Term Sources of Finance

I. Public Deposits

The deposits that are raised by organisations directly from the public are known as 'public deposits'. Any person who is interested in depositing money in an organisation can do so by filling up a prescribed form. The organisation in return issues a deposit receipt as acknowledgment of the debt. Public deposits can take care of both medium and short-term financial requirements of a business. The deposits are beneficial to both the depositor as well as to the organisation. While the depositors get higher interest rate than that offered by banks, the cost of deposits to the company is less than the cost of borrowings from banks. Companies generally invite public deposits for a period upto three years. The acceptance of public deposits is regulated by the Reserve Bank of India

Merits

The merits of public deposits are:

1. The procedure of obtaining deposits is simple and does not contain restrictive conditions as are generally there in a loan agreement;
2. Cost of public deposits is generally lower than the cost of borrowings from banks and financial institutions;
3. Public deposits do not usually create any charge on the assets of the company. The assets can be used as security for raising loans from other sources;
4. As the depositors do not have voting rights, the control of the company is not diluted.

Limitations

The major limitation of public deposits are as follows:

1. New companies generally find it difficult to raise funds through public deposits;
2. It is an unreliable source of finance as the public may not respond when the company needs money;
3. Collection of public deposits may prove difficult, particularly when the size of deposits required is large.

II. Commercial Banks

Commercial banks occupy a vital position as they provide funds for different purposes as well as for different time periods. Banks extend loans to firms of all sizes and in many ways, like, cash credits, overdrafts, term loans, purchase/discounting of bills, and issue of letter of credit. The rate of interest charged by banks depends on various factors such as the characteristics of the firm and the level of interest rates in the economy. The loan is repaid either in lump sum or in installments. Bank credit is not a permanent source of funds. Though banks have started extending loans for longer periods, generally such loans are used for medium to short periods. The borrower is required to provide some security or create a charge on the assets of the firm before a loan is sanctioned by a commercial bank.

Merits

The merits of raising funds from a commercial bank are as follows

1. Banks provide timely assistance to business by providing funds as and when needed by it.
2. Secrecy of business can be maintained as the information supplied to the bank by the borrowers is kept confidential;
3. Formalities such as issue of prospectus and underwriting are not required for raising loans from a bank. This, therefore, is an easier source of funds;
4. Loan from a bank is a flexible source of finance as the loan amount can be increased according to business needs and can be repaid in advance when funds are not needed.

Limitations

1. Funds are generally available for short periods and its extension or renewal is uncertain and difficult;
2. Banks make detailed investigation of the company's affairs, financial structure etc.,
3. It may also ask for security of assets and personal sureties. This makes the procedure of obtaining funds slightly difficult;

III. Lease Financing

A lease is a contractual agreement whereby one party i.e., the owner of an asset grants the other party the right to use the asset in return for a periodic payment. In other words it is a renting of an asset for some specified period. The owner of the assets is called the 'lessor' while the party that uses the assets is known as the 'lessee'

The lessee pays a fixed periodic amount called lease rental to the lessor for the use of the asset. The terms and conditions regulating the lease arrangements are given in the lease contract. At the end of the lease period, the asset goes back to the lessor. Lease finance provides an important means of modernisation and diversification to the firm. Such type of financing is more prevalent in the acquisition of such assets as computers and electronic equipment which become obsolete quicker because of the fast changing technological developments. While making the leasing decision, the cost of leasing an asset must be compared with the cost of owning the same.

C. Short-term Sources of Finance

The short-term loans and credits are raised by a firm for meetings its working capital requirements. These are generally for a short period not exceeding accounting period, i.e., one year. The main sources of short term funds are as follows.

I. Bank credit

Commercial banks extend the short-term financial assistance to business firms by means of bank credit. Bank credit may be provided in the following forms:

(a) Loans

Bank loans are provided for a specific short period. The amount of Loan depends upon the size and goodwill of the firm. Such advance is credited to a separate loan account and the borrower has to pay interest on the whole amount of loan irrespective of the amount of loan actually granted. Bank Loans are usually granted against the security of assets.

(b) Cash Credit

Bank grants the cash credit up to a specified limit. Business firms can withdraw any amount within that limit. Interest is charged on the actual amount drawn.

(c) Overdraft

Under overdraft financing facility, bank allows the business firm to withdraw the amount even more than the customer s balance in the bank. The limit of extra withdrawal is also fixed by the bank. This limit is decided on the basis of creditworthiness of the borrower. Interest is charged on the overdrawn money.

II. Trade Credit

Trade credit is the credit extended by one trader to another for the purchase of goods and services. Trade credit facilitates the purchase of supplies without immediate payment. Such credit appears in the records of the buyer of goods as 'sundry creditors' or 'accounts payable'. Trade credit is commonly used by business organizations as a source of short-term financing. It is granted to those customers who have reasonable amount of financial standing and goodwill.

III. Installment Credit

This is another method by which the assets are purchases and possession of goods is taken immediately but the payment is made in installment over a pre-determined period of time. Generally, interest is charged on the unpaid price or it may be adjusted in the price. But, in any case, it provides finds for sometimes and is used as a source of short-term working capital by many business organizations which have difficult funds positions.

IV. Advances

Some business organizations get advances from their customers and agents against orders and this source is short term source of finance for them. It is a cheap source of finance and in order to minimize their investments in working capital, some firms having long production cycle, especially the firms manufacturing industrial products prefer to take advance from their customers.

V. Commercial Paper

Commercial Paper emerged as a source of short term finance in our country in the early nineties. Commercial paper is an unsecured promissory note issued by a firm to raise funds for a short period, varying from 90 days to 364 days. It is issued by one firm to other business firms, insurance companies, pension funds and banks. The amount raised by CP is generally very large. As the debt is totally unsecured, the firms having good credit rating can issue the CP. Its regulation comes under the purview of the Reserve Bank of India.

9.2 Institutional Sources of Finance

The Government of India, in order to provide adequate supply of credit to various sectors of the economy, has evolved a well developed structure of financial institutions in the country. Depending upon the geographical coverage of their operations, these financial institutions can be broadly categorised into 1) All India institutions and 2) State level institutions. At the national level, they provide long and medium term loans at reasonable rates of interest. They subscribe to the debenture issues of companies, underwrite public issue of shares, guarantee loans and deferred payments, etc.The State level institutions are mainly concerned with the development of medium and small scale enterprises, but they provide the same type of financial assistance as the national level institutions.

I. National Level Institutions

A wide variety of financial institutions have been set up at the national level. They cater to the diverse financial requirements of the entrepreneurs. They include

1. All India development banks like IDBI, SIDBI, IFCI Ltd, IIBI;
2. Specialised financial institutions like IVCF, ICICI Venture Funds Ltd, TFCI ;
3. Investment institutions like LIC, GIC, UTI; etc.

A. All-India Development Banks (AIDBs)

Various All India Development Banks which provide institutional credit to not only large and medium enterprises but also help in promotion and development of small scale industrial units are as follows:

1. Industrial Development Bank of India (IDBI)

It was established in July 1964 as an apex financial institution for industrial development in the country. It caters to the diversified needs of medium and large scale industries in the form of financial assistance, both direct and indirect. Direct assistance is provided by way of project loans, underwriting of and direct subscription to industrial securities, soft loans, technical refund loans, etc. While, indirect assistance is in the form of refinance facilities to industrial concerns.

2. Industrial Finance Corporation of India Ltd (IFCI Ltd)

IFCI was the first development finance institution set up in 1948 under the IFCI Act in order to pioneer long-term institutional credit to medium and large industries. It aims to provide financial assistance to industry by way of rupee and foreign currency loans, underwrites/subscribes the issue of stocks, shares, bonds and debentures of industrial concerns, etc. It has also diversified its activities in the field of merchant banking, syndication of loans, formulation of rehabilitation programmes, assignments relating to amalgamations and mergers, etc.

3. Small Industries Development Bank of India (SIDBI)

SIDBI was set up by the Government of India in April 1990, as a wholly owned subsidiary of IDBI. It is the principal financial institution for promotion, financing and development of small scale industries in the economy. It aims to empower the Micro, Small and Medium Enterprises (MSME) sector with a view to contributing to the process of economic growth, employment generation and balanced regional development.

4. Industrial Investment Bank of India Ltd (IIBI)

It was set up in 1985 under the Industrial reconstruction Bank of India Act, 1984, as the principal credit and reconstruction agency for sick industrial units.

It was converted into IIBI on March 17, 1997, as a full-fledged development financial institution.

B. Specialised Financial Institutions (SFIs)

Specialised financial institutions are the institutions which have been set up to serve the increasing financial needs of commerce and trade in the area of venture capital, credit rating and leasing, etc.

1. **IFCI Venture Capital Funds Ltd (IVCF)**: Formerly known as Risk Capital & Technology Finance Corporation Ltd (RCTC), is a subsidiary of IFCI Ltd. It was promoted with the objective of broadening entrepreneurial base in the country by facilitating funding to ventures involving innovative product/process/ technology.

2. **ICICI Venture Funds Ltd:** Formerly known as Technology Development & Information Company of India Limited (TDICI), was founded in 1988 as a joint venture with the Unit Trust of India. Subsequently, it became a fully owned subsidiary of ICICI. It is a technology venture finance company, set up to sanction project finance for new technology ventures. The industrial units assisted by it are in the fields of computer, chemicals/polymers, drugs, diagnostics and vaccines, biotechnology, environmental engineering, etc.

3. **Tourism Finance Corporation of India Ltd. (TFCI):** TFCI is a specialised financial institution set up by the Government of India for promotion and growth of tourist industry in the country. Apart from conventional tourism projects, it provides financial assistance for non-conventional tourism projects like amusement parks, ropeways, car rental services, ferries for inland water transport, etc.

C. Investment Institutions:

These are the most popular form of financial intermediaries, which particularly catering to the needs of small savers and investors. They deploy their assets largely in marketable securities.

1. **Life Insurance Corporation of India (LIC):** LIC was established in 1956 as a wholly-owned corporation of the Government of India. It was formed by the Life Insurance Corporation Act, 1956, with the objective of spreading life insurance much more widely and in particular to the rural area. It also extends assistance for development of infrastructure facilities like housing, rural electrification, water supply, sewerage, etc. In addition, it extends resource support to other financial institutions through subscription to their shares and bonds, etc. The Life Insurance Corporation of India also transacts business abroad and has offices in Fiji, Mauritius and United Kingdom. Besides the branch operations, the Corporation has established overseas subsidiaries jointly with reputed local partners in Bahrain, Nepal and Sri Lanka.

2. **General Insurance Corporation of India (GIC):** GIC of India Limited is an Indian Public Sector insurance Company which was incorporated on 22 November 1972, under the Companies Act, 1956. The Corporation is restructured into four companies namely,

   (a) The New India Assurance Company Ltd.

   (b) United India Insurance Company Ltd.

   (c) Oriental Insurance Company Ltd.

   (d) National Insurance Company Ltd.

   With effect from 21 March 2003, the four companies were delinked from GIC. The objectives of GIC are;

   (a) to carry on the general insurance business such as fire, accident, theft etc.

   (b) to help and promote the subsidiaries to conduct the business of Insurance.

3. **Unit Trust of India (UTI):**

   UTI Mutual Fund is one of the leading mutual fund investment companies in India. It was setup on 1st February 1964 under the Unit Trust of India Act 1963. It is a Statutory Public Sector investment institution with an objective to encourage and mobilize the savings of the community and canalize them into productive corporate investment.

II. State Level Institutions

The important State level institutions which provide finance to entrepreneurs are SFCs and SIDCs.

(a) State Financial Corporation:

SFCs are setup under SFCs Act 1951. They provide financial assistance to small and medium enterprises. SFCs were setup as joint venture of state government and IDBI and are headed by professional managers appointed by government. SFCs get refinance facility from IDBI and SIDBI to provide finance to small and medium sectors. They provide loans to enterprises which are engaged in manufacture preservation or processing of goods, mining, hotel industry, generation or distribution of power, transportation, fishing, assembling, repairing etc.

(b) State Industrial Development Corporation:

SIDCs are state owned government corporations that engage in the development and promotion of medium and large industries. They aim to develop industrial infrastructure such as industrial parks and industrial estates along with providing financial assistance. They setup industrial projects either in joint sector collaboration with private entrepreneurs or on their own. Thus, SIDCs promote the medium and large enterprises, aids in the skill development and helps in facilitating industrial infrastructure development. It also provides publicity and marketing support to industries.

- Financial Institutions
  - National Level Institutions
    - All India Development Banks (AIDBs)
      1. IDBI
      2. IFCI
      3. SIDBI
      4. IIBI
    - Specialised Financial Institutions
      1. IFCI Venture Capital Funds Ltd.
      2. ICICI venture funds Ltd
      3. Tourism Finance Corporation of India
    - Investment Insitutions
      1. LIC
      2. UTI
      3. GIC
  - State Level Institutions
    1. SFC
    2. SIDCs

9.3 International Sources of Finance

Liberalisation and Globalisation processes initiated in India in 1991 have opened the gates for the foreigners to invest in India and vice versa. Since then certain international sources are available for financing purposes.

Some well known international sources of finance are described below.

1. American Depository Receipts (ADRs)

American depository receipt is issued by any U.S. Bank. The first ADR was introduced by J.P. Morgan in 1927 for the British retailers. It is basically a negotiable instrument which represents a specified number of share(s) in a foreign stock that is traded on a U.S. exchange. They are treated as foreign direct investment in the issuing company.

The majority of ADRs range in price from $10 to $100 per share. Currently four major commercial banks that provide depositary bank services are:

- BNY Mellon,
- J.P. Morgan,
- Citigroup, and
- Deutsche Bank

American Depository Receipts are listed on New York Stock Exchange, American Stock Exchange or NASDAQ. The holder of American depository receipt does not carry voting rights. Dividend on ADR is paid in terms of U.S Dollars.

2. Global Depository Receipt (GDRs)

A GDR is very similar to an American Depository Receipt. GDR is a bank certificate issued in more than one country for shares in a foreign company. There are more than 900 GDRs listed on exchanges worldwide. GDRs are mainly listed in the Frankfurt Stock Exchange, Luxembourg Stock Exchange and London Stock Exchange. Global depository receipts facilitate trade of shares. Several international banks issue GDRs such as Citigroup, J.P Morgan, Bank of New York, etc.

A holder of GDR does not carry any voting rights. A holder of GDR can convert it into the number of shares that it represents. On conversion of GDR into Equity shares, no remittance is to be made by the company.

3. Indian Depository Receipts (IDRs)

An IDR is an instrument in the form of a Depository Receipt created by the Indian depository in India against the underlying equity shares of the issuing company. IDRs are listed on stock exchanges in India and are freely transferable.

IDRs can be issued with the prior approval from Securities Exchange Board of India (SEBI). Application can be made for the same 90 days before the issue opening date. An IDR is denominated in Indian Rupees.

According to the guidelines of SEBI, only those companies listed in their home market for at least three years and which have been profitable for three of the preceding five years can issue IDRs. Standard Chartered is the first firm to issue IDRs. IDRs are similar to equity shares. IDR holders have the same rights as equity shareholders.

4. Foreign Currency Convertible Bonds (FCCBs)

In the present scenario of globalization, FCCBs have assumed a great importance for various multinational companies. A foreign currency convertible bond is a type of convertible bond in which the money is raised by the issuing company in the form of a foreign currency. FCCBs are issued in currencies different from the issuing company's domestic currency. Corporate issue FCCBs to raise money in foreign currencies. The instrument is a mix between equity and debt. FCCBs are redeemable at maturity if not converted into equity.

Summary

There are a number of ways of raising finance for a business. The type of finance chosen depends on the nature of the business. Large organisations are able to use a wider variety of finance sources than are smaller ones. Savings are an obvious way of putting money into a business. A small business can also borrow from families and friends. In contrast, companies raise finance by issuing shares. Large companies often have thousands of different shareholders.

Sources of finance can be categorized into three ways viz., Long-term sources, medium-term sources and short-term sources. Equity Shares, Preference Shares, Deferred Shares, Retained Earnings, Debentures, Loans from Financial Institutions are the long-term sources of finance. Loans from Banks, Public Deposits and Lease Financing are the medium –term finances. The short-term loans and credits are raised by firm for meetings its working capital requirements.

Equity shares represent the ownership capital of a company. Due to their fluctuating earnings, equity shareholders are called risk bearers of the company. These shareholders enjoy higher returns during prosperity and have a say in the management of a company, through exercising their voting rights.

Debenture represents the loan capital of a company and the holders of debentures are the creditors. These are the fixed charged funds that carry a fixed rate of interest. The issue of debentures is suitable in the situation when the sales and earnings of the company are relatively stable.

Both central and state governments have established a number of financial institutions all over the country to provide industrial finance to companies engaged in business. They are also called development banks. This source of financing is considered suitable when large funds are required for expansion, reorganisation and modernization of the enterprise.

Questions

I. Essay Type Questions

1. Explain various sources of business finance available to Indian business men.
2. Discuss the main sources of finance available to companies for meeting long-term as well as short-term financial requirements?
3. Write a comparative evaluation of the various methods that are opened to meet the financial requirements of a business firm.
4. What do you mean by Specialized Financial Institutions? Why are these needed?
5. Critically examine the advantages and disadvantages of raising funds by issuing shares of different types.

II. Short Answer Type Questions

1. What are the sources of Short term finance?
2. What are the sources of Long-term finance?
3. What are the sources of medium term finance?
4. Discuss the need for specialized financial institutions.
5. Explain the advantages and disadvantages of equity source of finance.
6. Differentiate between the equity shares and Preference shares.
7. Differentiate between a Share and a Debenture
8. What do you know about GIC?

III. Very Short Answer Questions

1. Business finance
2. Bank loan
3. Debentures
4. Trade Credit
5. Equity share
6. Preference share
7. Retained earnings
8. Deferred Shares
9. State Financial Corporation
10. Commercial Banks
11. Financial Institutions
12. UTI
13. SFC
14. SIDC

Student activity

1. To prepare a comparative chart of all the sources of business finance (Long, medium and short terms).
2. To collect the information about various financial institutions that are providing financial assistance to local business units.

Unit - V

MSMEs, MNCs and Emerging Trends in Business

Micro, Small and Medium Enterprises (MSMEs)

CHAPTER

10

Introduction

The conceptual and legal framework for small and ancillary industrial undertakings The Micro, Small and Medium Enterprises Development Act, 2006 is the latest of the initiatives taken by the Government for promoting development of the small scale industry sector. Small-scale industries have been the backbone of the industrial sector of country's economy and have always been a major area of concern for the Government. Small- scale industries have enjoyed special privileges and incentives in all strategies adopted to boost overall industrial growth. In the Industrial Policy Document of 1991, which laid the platform for first generation economic reforms in India, small-scale enterprises have been awarded a special status by notifying reservation of items for exclusive manufacture in the SSI sector.

The second phase of economic reforms too has laid much emphasis on development of small-scale sector. In this direction, with a view to provide an appropriate legal framework for the sector to facilitate its growth and development, the Government has recently enacted the Micro, Small and Medium Enterprises Development Act, 2006 which received the assent of the President of India on 16.6.2006. The Act came into force with effect from 2.10.2006. A number of amendments have been made to the Act to encourage the entrepreneurs. The recent budget of Union government 2023 proposed a number of changes to the Act.

Objective of the Act

The Micro, Small and Medium Enterprises Development Act 2006 envisages to provide for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises and for matters connected therewith or incidental thereto.

10.1 Meaning and Definition of Enterprise and MSMEs

The term 'enterprise' has been defined under section 2(e) so as to mean 'any industrial undertaking or a business concern or any other establishment, by whatever name called, engaged in the manufacture or production of goods, in any manner pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 or engaged in providing or rendering of any service or services.'

Classification of Enterprises

The term 'enterprise' includes:

- Proprietorship;
- Hindu Undivided Family;
- Association of Persons;
- Co-operative Society;
- Partnership;
- Undertaking;
- Or any other legal entity.

Definitions of Micro, Small & Medium Enterprises

In accordance with the provision of Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 the Micro, Small and Medium Enterprises (MSME) are classified in two Classes. They are

1. Manufacturing Enterprises and
2. Service Enterprises.

(A) Manufacturing Enterprises

Manufacturing enterprises are those business enterprises which are engaged in the manufacturing or production of goods or commodities. More specifically, these enterprises involve in converting the raw material into finished products by using plant and machinery for creating value addition to the final products. From the point of view of MSMEs, the manufacturing enterprises are defined in terms of investment made in Plant & Machinery and annual turnover.

i) **A micro enterprise** is an enterprise where investment in plant and machinery does not exceed Rs. One crore and annual turnover is not more than Rs. Five crore

ii) **A small enterprise** is an enterprise where the investment in plant and machinery is more than Rs. 10 crore and annual turnover is not more than Rs. 50 crore.

iii) **A medium enterprise** is an enterprise where in the investment in plant and machinery is more than Rs.50 crore and annual turnover is not more than Rs.250 crore.

(B) Service Enterprises

Service enterprise is an enterprise engaged in providing or rendering of services. Services enterprises are defined in terms of investment made in Plant & Machinery and annual turnover.

i) **A micro enterprise** is an enterprise where the investment in equipment does not exceed Rs. One crore and annual turnover is not more than Rs. 5 crore.

ii) **A small enterprise** is an enterprise where the investment in equipment is more than Rs. 10 crore and annual turnover is not more than Rs. 50 crore.

iii) **A medium enterprise** is an enterprise where the investment in equipment is more than Rs.50 crore and annual turnover is not more than Rs.250 crore.

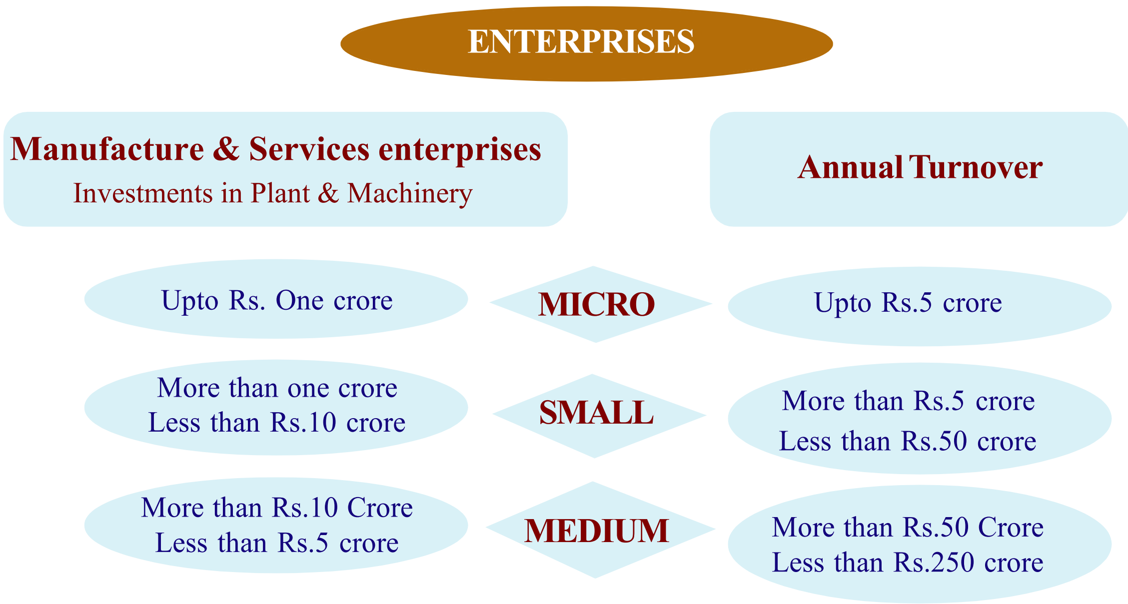
In brief, the definitions of MSMEs explained above are presented in the following exhibit and figure.

Exibit-I

A. Manufacturing Sector and Service Enterprises

Enterprises	Investment in plant & machinery	Annual Tournover
Micro Enterprises	Does not exceed one crore rupees	Does not exceed Rs.5 crore
Small Enterprises	Not more than Ten crore rupees	Does not exceed Rs.50 crore
Medium Enterprises	Not more than Fifty crore rupees	Does not exceed Rs.250 crore

Figure-10.1



10.2 Registration Requirements under the Msmed Act, 2006

As per the Act, any person intending to establish,-

- a micro or small enterprise, may, at his discretion;
- a medium enterprise engaged in providing or rendering of services may, at his discretion; or

- a medium enterprise engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, shall file the memorandum of micro, small or, as the case may be, of medium enterprise with authority specified by the State Government or the Central Government.

10.3 Significance of MSMEs

Micro, Small and Medium Enterprises (MSME) contribute nearly 8 per cent of the country's GDP, 45 per cent of the manufacturing output and 40 percent of the exports. They provide the largest share of employment after agriculture. They are the nurseries for entrepreneurship and innovation. They are widely dispersed across the country and produce a diverse range of products and services to meet the needs of the local markets, the global market, the national and international value chains.

The Ministry of MSME has undertaken number of programs to help and assist entrepreneurs and small businesses. Entrepreneurs who are planning to set up business, may contact National Institute for Entrepreneurship and Small Business Development, National Institute for Micro, Small and Medium Enterprises), Indian Institute of Entrepreneurship or the Development Commissioner for details about their programs and business plans. The significance of MSMEs can be understood from the following:

a) 90% of MSMEs in India are unregistered (out of which nearly 80%are sole proprietor Firms)

b) 40% of exports in India are through MSME channel

c) 40% of employment opportunity in India is provided by MSME sector

d) MSMEs provide opportunities to the budding entrepreneurs by providing various channels of Investment opportunity according to their class of Investment

e) MSMEs provide a good market for foreign companies to start venture capital businesses in India.

10.4 Privileges Offered to Micro, Small and Medium Enterprises

In furtherance of its objectives stated earlier, the Act envisages to confer following privileges on micro, small and medium enterprises:

1. Buyer's Liability to make Timely Payment for Goods and Services

Section 15 envisages to ensure timely receipt of payment for their goods and services by micro and small enterprises. It casts an obligation upon the buyer of any goods or services, to make payment to the supplier, by the specified date as follows:

(a) *When there is an agreement in writing:* On or before the date agreed upon between them in writing. Further, in no case the period so agreed shall exceed 45 days from the day of acceptance.

(b) *When there is no agreement:* Before the appointed day, which means the day following immediately after the expiry of 15 days from the day of acceptance or day of deemed acceptance

The terms 'buyer', 'supplier', 'day of acceptance' have been defined in the Act, as under:

'Buyer' means a person buying any goods or receiving any services from a supplier for consideration.

'Supplier' means a micro or small enterprise

'Day of acceptance' means the day of actual delivery of goods or rendering of services, or

2. Interest for Delayed Payment by Buyer

Where a buyer fails to make payment as required above, he shall be liable to pay interest on the outstanding amount. The interest shall be payable for the period of delay from the date immediately following the agreed date. The interest shall be payable at a rate three times the bank rate and compounded at monthly rests.

3. Reference of Disputes

Any dispute relating to amount payable for any goods or services, and any interest thereon, may be referred by any party, to the Micro and Small Enterprises Facilitation Council, which shall conduct conciliation in the matter.

10.5 Other Promotional Measures for MSMEs

The following are the measures for promotion, development and enhancement of competitiveness of micro, small and medium enterprises, to be undertaken by the Central Government, State Government and the Reserve Bank of India. These are briefly as under:

1. Programmes, to facilitate development of skill in the employees, management and entrepreneurs, provisioning for technological upgradation, marketing assistance or infrastructure facilities and cluster development of micro, small and medium enterprises.

2. Credit facilities to ensure timely and smooth flow of credit to such enterprises, minimise the incidence of sickness among and enhance the competitiveness of such enterprises.

3. Preferential Procurement of Goods and Services produced or provided by such enterprises, by the Government, its aided institutions and public sector enterprises.

4. Government Grants to the notified Fund or Funds constituted to be utilised exclusively for the measures for promotion and development of such enterprises.

Summary

The Small and Medium Enterprises Development Bill 2005 which was enacted in June 2006 was renamed as "Micro, Small & Medium Enterprises Development Act, 2006". It aims to facilitate the promotion and development of small and medium enterprises in India. As per the MSME Act 2006, MSMEs are classified into two categories. ie, Manufacturing enterprises and Service enterprises. These enterprises have been defined in terms of the ceiling in investment in plant and machinery and annual turnover. These enterprises are offered some privileges by the Government for their promotion, growth and development country like India. MSMEs contribute nearly 8 per cent of the country's GDP, 45 per cent of the manufacturing output and 40 per cent of the exports. They provide the largest share of employment after agriculture sector.

Questions

I. Essay Type Questions

1. Define MSMEs and explain their significance.
2. Discuss the previleges enjoyed by MSMEs.

II. Short Answer Type Questions

1. Define Manufacturing enterprises as per MSMEs Act, 2006
2. Define Service enterprises as per MSMEs Act, 2006.
3. Briefly explain the registration process of MSMEs.
4. What are the promotional measures undertaken for MSMEs ?
5. What are the objectives of MSMEs ?

III. Very Short Answer Type Questions

1. Micro Enterprises
2. Small Enterprises
3. Medium Enterprises
4. Manufacturing enterprise
5. Service enterprise.

Student Activity

Identify the industrial units situated in your locality and classify them into MSMEs.

Multi-National Corporations (MNCs)

CHAPTER 11

11.1 Meaning and Definitions

Globalisation refers to the increasing integration of markets (exchange) and production, to include the mobility of resources (capital, labour, 'organization and knowledge').

Foreign Direct Investment (FDI) is the control of production which takes place in one country ('host country') by a firm based in another country ('home country'). FDI is the defining feature of the multinational corporation (MNC). Foreign direct investment (FDI) occurs when a firm invests resources in business activities outside its home country

International trade occurs when a firm exports goods or services to consumers in another country.

Multinational Corporation refers to a corporate giant business firm having extended its productive activity in many nations besides its home country.

11.2 Necessity of Globalization

The world is moving away from self-contained national economies toward an interdependent, integrated global economic system. Globalization refers to the shift toward a more integrated and interdependent world economy.

Globalization has two facets:

1) The globalization of markets
2) The globalization of production

a. Globalization of Markets

- The globalization of markets refers to the merging of historically distinct and separate national markets into one huge global marketplace
- Falling trade barriers make it easier to sell internationally
- The tastes and preferences of consumers are converging on some global norm
- Firms help create the global market by offering the same basic products world-wide

b. Globalisation of Production:

- The globalization of production refers to the sourcing of goods and services from locations around the globe to take advantage of national differences in the cost and quality of factors of production like land, labor, and capital
- Companies compete more effectively by lowering their overall cost structure or improving the quality or functionality of their product offering

Two macro factors underline the trend toward greater globalization:

1) Low trade barriers
2) Technological change

a. Low Trade Barriers

The decline in barriers to the free flow of goods, services, and capital that has occurred since the end of World War II.

After World War II, advanced countries made a commitment to lower barriers to trade and investment

Lower barriers to trade and investment mean:

- that firms can view the world, rather than a single country, as their market
- that firms can base production in the optimal location for that activity

b. Technological Change

Technological change has made the globalization of markets a reality. Important advances have occurred in:

- microprocessors and telecommunications
- the Internet and World Wide Web
- transportation technology

Implications of technological change for the globalization of production include:

- lower transportation costs that enable firms to disperse production to economical, geographically separate locations
- lower information processing and communication costs that enable firms to create and manage globally dispersed production systems.

11.3 Multi-national Corporations

The term "Multinational" is made out of two words "Multi and national". So, Multinationals means a company which operates in more than one country or which has access to International markets. Multinational corporations are called by different names such as transnational corporation, global enterprise or international enterprise. Examples of MNCs are : Pepsi , Hyundai , Nike , Reebok , LG , Samsung and many more.

Definition of MNCs

The term "multinational corporation" is variedly defined. In a broad sense, Multinational Corporation refers to a corporate giant business firm having extended its productive activity in many nations besides its home country.

David E. Liliental, considering a wider parameter, defines the MNCs as "corporations which have their home in one country but operate and live under the laws and customs of other countries as well." For brevity, MNC refers to the business enterprise operating in more than one nation.

In a report of the International Labour Organisation (ILO), it is observed that, "the essential of the MNC lies in the fact that its managerial headquarters are located in one country (home country), while the enterprise carries out operations in a number of the other countries (host countries)."

It follows that even the firms participating in foreign trade or international economic relations simply by exporting or by licensing technology are not regarded as MNCs. To qualify to be a MNC, the firm must carry on production activity by its actual investment in several countries.

In India, the Foreign Exchange Regulation Act, 1973 (FERA) provides a specific definition of multinational corporation as follows:

"A corporation incorporated in a foreign country or territory shall be deemed to be multinational corporation if such corporation (a) is a subsidiary or a branch or has place of business in two or more countries or territories, (b) carries on business or otherwise operations in two or more countries or territories."

11.4 Features of MNCs

1. **Giant Size :** The assets and sale of Multinational corporations are quite large. These companies operate on large scale as they trade in more than one companies. These companies generate large wealth. Their operations are so huge that sometimes their sales turnover exceeds the Gross National Product of a developing Countries. By this we can imagine about the powers and calibre of a multinational company. For Example, the physical assets of IBM exceeds 8 billion dollars.

2. **International Operation :** A multinational corporation operates in more than one country . It has branches , factories , offices in several countries. It operates through a network of branches and subsidiaries in host countries. They sell their products in different countries . e.g. : Coca Cola , apple etc. Also there

are MNCs having Indian origin. For eg: Infosys, Airtel, Dr. Reddys lab etc.

3. **Professional Management :** A Multinational corporation employs professional experts , specialised people. MNCs try to keep their employees updated by imparting them training from time to time. It employs professionals to handle the advance in technology effectively.

4. **Centralized Control:** The branches of Multinational companies spread in different countries are controlled and managed from the headquarters situated in the home country. All branches operate within the policy framework formed by headquarters.

5. **Oligopolistic Powers:** Oligopoly means power in the hands of few companies only . Due to their giant size, the multinational companies occupy dominating position in the market .They join hands with big business houses and give rise to monopoly. They also take over other firms to acquire huge power and improve market share

6. **Sophisticated Technology**: Multinational companies make use of latest and advanced technology to supply world class products. They use capital-intensive technology and innovative techniques of production.

11.5 Advantages and disadvantages of MNCs

MNCs directly and indirectly help both the home country and the host country. There are also some disadvantages of MNCs to both the home country and the host country. Various advantages and disadvantages of MNCs on both the home country and host country are explained below.

Advantages of MNCs for the Host Country

MNCs help the host country in the following ways

1. The investment level, employment level and income level of the host country increases due to the operation of MNCs.

2. The industries of host country get latest technology from foreign countries through MNCs.
3. The host country's business also gets management expertise from MNCs.
4. The domestic traders and market intermediaries of the host country gets increased business from the operation of MNCs.
5. MNCs break protectionalism, curb local monopolies, create competition among domestic companies and thus enhance their competitiveness.
6. Domestic industries can make use of R & D outcomes of MNCs.
7. The host country can reduce imports and increase exports due to goods produced by MNCs in the host country. This helps to improve balance of payment.
8. Level of industrial and economic development increases due to the growth of MNCs in the host country.

Advantages of MNCs for the Home Country

MNCs home country has the following advantages.

1. MNCs create opportunities for marketing the products produced in the home country throughout the world.
2. They create employment opportunities to the people of home country both at home and abroad.
3. It gives a boost to the industrial activities of home country.
4. MNCs help to maintain favourable balance of payment of the home country in the long run.
5. Home country can also get the benefit of foreign culture brought by MNCs.

Disadvantages of MNCs for the Host Country

1. MNCs may transfer technology which has become outdated in the home country.
2. As MNCs do not operate within the national autonomy, they may pose a threat to the economic and political sovereignty of host countries.

3. MNCs may kill the domestic industry by monpolising the host country's market.

4. In order to make profit, MNCs may use natural resources of the home country indiscriminately and cause depletion of the resources.

5. A large sums of money flows to foreign countries in terms of payments towards profits, dividends and royalty.

Disadvantages of MNCs for the Home Country

1. MNCs transfer the capital from the home country to various host countries causing unfavourable balance of payment.

2. MNCs may not create employment opportunities to the people of home country if it adopts geocentric approach.

3. As investments in foreign countries is more profitable, MNCs may neglect the home countries industrial and economic development.

Summary

A multinational corporation/company is an organization doing business in more than one country. The multinational corporation is a business organization whose activities are located in two or more than two countries and is the organizational form that invites Foreign Direct Investment (FDI).

In brief, a multinational company carries its business operations in two or more countries. Its headquarters are located in one country (home country) but its activities are spread over in other countries (host countries). MNC's may engage in various activities like exporting, importing, manufacturing in different countries. The distinctive features of multinational companies include, large in size, worldwide operations, international management, mobility of resources, integrated activities. MNCs have many advantages and also have certain limitations both for the home country and host country.

Questions

I. Essay Type Questions

1. Define MNC and explain it Features.
2. Define MNC and explain the Advantages of MNCs.
3. Define MNC and explain the Limitations of MNCs.
4. What is globalisation and explain the necessity of Globalisation?

II. Short Answer Questions

1. Explain the meaning of MNC
2. List out the features of MNCs
3. State any four merits of MNCs to host country.
4. Explain any four merits of MNCs to home country.
5. Explain any four advantages to the host country.
6. State any four disadvantages to home country

III. Very Short Answer Questions

1. Globalisation
2. FDI
3. MNC
4. Globalisation of Markets.

Student Acivity

Identify any ten Indian companies which have global presence and try know their origin and growth.

Emerging Trends in Business

CHAPTER
12

Introduction

The e-business concept is new in Indian economy but has significantly evolved benefitting economy with higher gains. The Indian traditional marketing system is absorbing the new technological approach in-order to cope with international market and vast growing Indian consumer market. The e-business is part of new technology adopted in every sector of market benefitting the economy with wider scope and approachability with higher consumer base and consumer satisfaction. The open international market and globalization has pushed market and economy to adopt the new technology usage to cope up with larger tasks and data with high level of perfection.

12.1 Meaning and definition of e - business

The term "e-Business" refers to the integration of business tools based on ICT to improve the functioning of the company. The term e-Commerce, which is frequently mixed up with the term e-Business, it covers one aspect of e-Business, i.e., the use of an online support for the relationship building between a company and clients.

The term ‘e-business’ was first used by IBM in 1997, it defined e-business as “the transformation of key business processes through the use of internet technologies”.

“E-business” is defined as the application of information and communication technologies (ICT) which support all the activities and realms of business. It focuses on the use of ICT to enable the external activities and relationship of the business with customers. It also enables enterprises to link their internal and external data processing systems more efficiently and flexibly and serve better to the needs and expectations of their customers. E-Business uses web based technology to improve relationships with customers.

Implementing an e-Business project necessarily involves the deployment of a network or web-interface connecting company specific services to the client. The implementation of just computer tools is not enough; an e-Business project has to be implemented in a new organization based on new technologies. The concept of e-Business is very flexible and therefore covers all possible uses of information and communication technologies (ICT).

Some Statistics of Indian E-Business industry

- ❖ India, at present, is the worlds 3rd largest internet market, with 10 Crore internet users.
- ❖ Indian E-business industry stood at US$ 2.5 billion in 2009, which rose by 600% to US$ 16 billion in 2013.
- ❖ It is further expected to rise to US$ 56 billion by 2023.

12.2 Scope of E-business

E-business can be divided into following areas a) within the organization b) business – to – business (B2B) dealings, c) business – to – customer (B2C) transactions. d) customer – to –customer and e) customer – to – business.

a) B2B E-business refers to an exchange of products & services by one business & another.

b) B2C E-business refers to an exchange of products & services from a business to a customer.

c) C2C transactions are being facilitated by websites like quicker, olx, where customers offer their products online, to be bought by other customers.

d) C2B transactions involve provision of project work by customers on internet to the needy companies.

These C2C & C2B transactions are a result of recent advancements in technology.

Most of us are aware of buying products online through some sites like Flipkart, Jabong & Amazon. Almost everything from gym equipment to laptops, apparels to jewelries, are avilable online in this age of e-commerce. Even people are also buying services online. Business Consultants, lawyers & Doctors are offering their services/ advices to their potential clients via internet.

Electronic business is a super set of business cases. E-commerce is one of the aspects of e-business. Some other important aspects of e-business, which are successfully carried through the internet, are e-auctioning, e-banking, e-directories, e-engineering, e-franchising, e-gambling, e-learning, e-mailing, e-marketing, e-operational resource management e-supply and e-trading. The scope of e-business is discussed in terms of the following broad elements, viz.,

1. **E-commerce**: Transacting or facilitating business through Internet is called e-commerce. E-Commerce is short for "Electronic Commerce".

   Popular examples of ecommerce revolve around buying and selling online. But the ecommerce universe contains other types of activities as well. Any form of business transaction conducted electronically is e-commerce.

2. **E-auctioning**: The internet enables people to participate in the auction without sacrificing their personal time. In e-auctioning the people, who want to participate in the auction, visit the website with a click and go through the details of goods offered or kept in auction in concerned web pages and participate in auction. Eg: Bank Auctions tenders.

3. **E-banking**: Electronic banking is one of the most successful online business. E-banking allows customers to access their accounts and execute orders through use of website. Online banking allows the customers to get their money from an Automated Teller Machine (ATM), instead of walking up to the cash desk in

the bank, can view their accounts, transfer funds and can pay bills. Eg. Net Banking.

4. **E-marketing**: Electronic marketing provides a worldwide platform for buying and selling of goods without having any geographical barriers. The internet allows companies to react to individual customer demands immediately without any loss of time. It does not matter where the customer is located. By e-mails etc.,

5. **E-trading:** E-Trading is also known as “online trading” or e-broking. It is used for buying and selling stocks in stock exchanges.

12.3 Benefits of E-business

E-business has many advantages which can be broadly classified into the following categories.

A) Benefits to Consumer

- **Shopping at ease:** E-business enables customers to shop or do other transactions 24 hours a day, round the year from almost any location.
- **Wide Choice:** Customers will have more choices or more alternative products and services.
- **Price savings:** E-Business provides customers with less expensive products and services by allowing them to shop in many places and conduct quick comparisons. E-business facilitates competition, which results in substantial discounts.
- **Exchange of information:** Allows customers to interact with other customers and exchange their opinions and experiences on products purchased.

B) Benefits to Organization

- **Reach beyond boundaries:** Extends the market place to national and international markets.
- **Cost savings:** Reduces the cost of creating, processing, distributing, storing and retrieving information. Allows reduced inventories and overheads.

- **Competitive benefits:** Reduced processing time allows for customization of products and services for achieving competitive advantages.
- **Earlier capital collection:** Reduces the time between the outlay of capital and the receipt of products and services.

C) Benefits to Society

- **Environmental benefits:** Enables more individuals to work at home, and to do less travelling for shopping, resulting in less traffic on the roads, and lower air pollution.
- **Public Welfare:** Allows some merchandise to be sold at lower prices benefiting the poor ones.
- **Availability of products:** Enables people in Third World countries and rural areas to enjoy produces and services which otherwise are not available to them.

Risks faced while involving in a E-Business transaction

- Risk of the information being unauthorized altered while travelling the internet.
- Risks related to confidentiality of personal information and banking information like credit card details & passwords, etc.
- Risks relating to legal enforceability of transactions entered through e-commerce are of major concern since there will be no physical proof for such transactions.
- Risks of failure of electronic communications, which may result in closure of business.
- Risks to the management in controlling and clearing the E-commerce transactions and in selecting the best suitable communication techniques to transact.
- Risks relating to technology, like viruses and hacking.

12.4 Opportunities and Challenges of Business in 21st Century

The 21st century businesses are opening up many opportunities for entrepreneurs to grow and also equally pose many challenges. The future business is defined by the ability to see an opportunity in ideas, knowledge and intellectual resources, as most of the economies are opening up their doors for free trade and exposing to the new fields of operations.

India's positive economic outlook and regularly reforms have made it an attractive market for foreign investors. Similarly, Business enterprises in India have been facing many challenges in changing business environment. Understanding and preparing for these challenges is the key to success for business enterprises in India.

Peter F. Drucker, in his book 'Management Challenges for the 21st Century' provides insightful and timely information for individuals and organization alike as they work towards common goals in the next one hundred years. He also emphasized on certain new assumptions for the 21st century managers that are essential for viewing the roles of individuals and management in both profit and not-for-profit organizations.

12.5 Opportunities

The following are the opportunities of business enterprises in 21st century:

1. **LPG:** The economic reforms initiated in the form of Liberalization, Privatization and Globalization (LPG) have brought in structural changes which ultimately created favorable environment for business enterprises in India. This led to integration of Indian economy with world economies, improved access to technology, growth of international trade, increase in production and employment opportunities, free flow of capital etc.,

2. **Increase in size and diversification**: The 21st Century business enterprises are characterized with large sized and highly diversified organizations. By taking the advantage of the opportunities that come from size and increased output, companies are able to reduce their costs and thereby increase in profits.

3. **Increase in per capita income**: India has emerged as the fourth largest economy globally with a high growth rate with its improved its per capita income. Per capital income is the measure of living standards of its people in a country. As India's per capita income is increasing, the business opportunities are also increasing in India.

4. **Market economies**: The Indian economy being one of the largest economies in the world with a population of more than 1.2 billion is flourishing and attracting industrial, trade and service sectors all around the world. With changes in the international economic order, India had converted itself into a market economy. As a result, business organizations have various business opportunities in India.

5. **E-commerce – A gate way to global markets**: Business enterprises across the globe are discovering the benefits of electronic commerce. Improved cash flow, customer retention, and service satisfaction are some of the benefits gained from e-commerce.

6. **Technological advancements**: 21st century business enterprises are able to use ultramodern technology. With the advancement of technology, organizations are able to offer services, which are relevant, cost effective and compatible with society's needs.

7. **Expansion of financial services**: In 21st century, the financial services sector has been growing enormously. Banking Insurance, debt and equity financing, micro finance sectors, are helping the people to save money and to get liberal credit for their future needs. It resulted in widening of business expansion opportunities for the companies in this sector.

8. **Automation of business processes**: Business Process Automation (BPA) is the strategy that a business uses to automate processes in order to curtail costs. The objective of BPA is not only to automate business processes, but also to simplify and improve business workflows in terms of achieving greater efficiency, adapting to changing business needs and reducing potentiality human error.

9. **Growing mergers, acquisitions and foreign collaborations**: mergers and acquisitions is a strategy of modern business enterprises for improving innovation, profitability, market share and stock prices. This helps in generating cost

effectiveness through economies of scale, greater efficiency, and increased tax efficiency.

10. **Scope for International Entrepreneurship:** In 21st century, many organizations are globalizing their businesses in terms of manufacturing, service delivery, capital sourcing, or talent acquisition as a defensive strategy. Similarly these are discovering a new business opportunities in more than one country to create new products or services to suit to the diversified needs of the customers.

12.6 Challenges

The following are the challenges of business enterprises in 21st century:

1. **Threat of Technology**: Rapid changes in technology have been a great threat for the business enterprises especially for small ones in terms of cost and time. Business organizations have to adopt themselves in tune with the changing technology and modernize their plant and equipment and processes, if not they will become outdated in the market.
2. **Growing Consumer Awareness**: Growing consumer awareness about the products and services will continue to drive sustainability of business in 21 st century. Businesses need to respond to consumer demand to gain customers and avoid losing their market share.
3. **Challenges of Globalization**: Globalization is leading to strategic challenges of mixed cultures and languages in the business environment. This gives rise to increased global competition and increased prices of goods and services.
4. **Depleting Natural Resources**: Most of the manufacturing enterprises depend upon certain natural resources which is a key source of raw materials. The natural resources such as mineral, metals, forests, fossil fuels, and healthy soils are rapidly being depleted, and these valuable gifts of nature are in danger of total disappearance. This will have a direct impact on the growth of business enterprises in the years to come.
5. **Economic Recession**: International economic and political order has been changing throughout the globe. Economic recession took place in the United States and Europe

is slowly showing its affects on performance of business enterprises in other countries also.

6. **Information Challenges**: Information technology supported by a new world infrastructure of data communications and telecommunications i.e., use of internet, wireless, e-commerce as part of management tools and easing of technology transfer has posed a bigger challenge for 21st century business enterprises.

7. **The Challenge of the Environment**: Environmental degradation is one of the biggest challenges of businesses organizations facing today. Economic, social, political, legal, technological environments have been changing rapidly. Pollution and global warming are the challenges, which all countries are facing.

8. **Corruption and Bureaucratic Hurdles**: Corruption is a very big hurdle for doing business in modern days. Corruption is well entrenched in India and pervades many aspects of daily life. Corruption is often cited as a barrier to the effective development of the private sector and poses business risks.

9. **Changing Regulatory Framework**: A changing regulatory environment is always of concern in certain industries. Two key areas of regulatory challenges are taxes and health care. Political and regulatory risks can also pose a big challenge for business enterprise in 21st century. The threat of increased costs due to new carbon taxes and presser to 'go green' is another challenge.

10. **Transparency and Governance**: Corporate Governance involves organizing and prioritizing a variety of interests. Decisions adopted by corporations are influenced by the way those interests are structured. Modern companies are in surveillance of transparency and governance issues.

11. **Corporate Social Responsibility (CSR)**: The practical implementation of CSR is facing with a lot of issues and challenges. In India CSR is in a very much budding stage. A lack of understanding, inadequate trained personnel, coverage, policy initiatives etc., are a few hurdles of CSR programs.

12. **Foreign Exchange Risk**: Foreign exchange risk is another factor causing constant instability in the running of business organizations. This has been caused by other

external factors such as exchange rates, amount of exports and imports and political factors.

13. **Security Issues**: Security threat to business has become more pronounced in 21st century. With the proliferation of Electronic Commerce and the "Virtual Office," threats are becoming everyday occurrence to business. Threats to business can happen in various forms like information security, internet security, physical security, Wireless Access to the company network, risk management, insider threat, privacy laws etc.,

14. **Human Resource Challenges**: One of the biggest challenges of 21st century businesses is Human Resources – finding the right staff, training and retaining them are concerns of the HR function. Because of changing technology, business enterprises are struggling to find qualified workers with IT skills, problem solving abilities, and deductive reasoning skills. In 21st Century, managers must understand the cultures around the world and operate at global level. Effective handling of company's human resources is the biggest challenge in modern times.

Summary

The term "E-Business" refers to the integration of business tools based on Information and Communication Technology (ICT) to improve the functioning of the company. The term e-Commerce is frequently mixed up with the term e-Business. It covers one aspect of e-Business, i.e., the use of an online support for the relationship building between a company and the clients. The objective of e-business is to create communication between the company and its internal processes to better control internal and external measures. The e-business awareness in India has increased with fast adaption of intranet and internet based services in today's post-economic liberalization scenario. E-business can be divided into three areas. Viz.., a) within the organization. B) business – to – business (B2B) dealings, and c) business – to – customer (B2C) transactions.

The 21st century business is opening up many opportunities for entrepreneurs as well posed for many critical challenges also. The future business is defined by the ability to see opportunity in ideas, knowledge and intellectual resources, as most of the

economies are opening up their doors for free trade and exposing to the new fields of operations. Business enterprises in India have been facing many challenges in changing business environment. Understanding and preparing for these challenges is the key to success for business enterprises in India.

Questions

I. Essay Type Questions

1. Define E-business and explain the scope of e-business.
2. Explain the benefits of E-business.
3. Explain the opportunities of business enterprises in 21st century.
4. Explain the challenges of business enterprises in 21st century.

II. Short Answer type Questions:

1. Explain the scope of E-business.
2. What are the benefits of e-business to organizations?
3. What are the benefits of e-business to customers?
4. Briefly outline the risks faced while involving in a E-business transaction.
5. What are the benefits of e-business to the society?

III. Very Short Answer Questions

1. E-business
2. E- banking
3. E- marketing
4. E-commerce
5. E-auctioning
6. E-trading

Student Acivity

Identify the products that are suitable for e-business transactions.

Board of Intermediate Education, A.P., Hyderabad

Model Question Paper (w.e.f 2014-15)

Commerce - First Year

Time : 3 hrs **Max Marks : 100**

PART - I (50 Marks)

Section A

Answer any TWO of the following questions in not exceeding 40 lines each. 2x10 = 20

1. Define a partnership firm and explain the features of it..
2. Explain about memorandum of Association and the clauses of it.
3. Define 'Debenture' and write about various types of debentures.

Section B

Answer any FOUR of the following questions in not exceeding 20 lines each. 4x5 = 20

4. Discuss about various types of Industries.
5. Explain any five principles of a cooperative society.
6. Draw any five differences between a Public Company and a Private Limited Company.
7. Define Business finance and explain the significance of it.
8. Write a brief note on multinational corporations.
9. Define e-business and explain its scope.

Section C

Answer any FIVE of the following questions in not exceeding 5 lines each. 5 x 2 = 10

10. Business
11. Insurance
12. 'Day at hyga Principle'
13. Minor partner
14. What is a Government Company?
15. Prospectus
16. Explain retained earnings
17. Medium enterprise.

PART - II (50 Marks)

Section D

Answer the following question in not exceeding 40 lines each. 1x20 = 20

18 From the following Trail Balance of Maanas Prepare trading & Profit and loss a/c for the year ended 31st December 2012 and Blanace sheet as on that date.

Trial Balanace as on 31-12-2012

Debit Balances	**Rs.**	**Credit Balances**	**Rs.**
Purchases	90,000	Sales	1,45,000
Returns	2,000	Returns	2,000
Cash in Hand	5,000	Commission	3,000
Cash at Bank	8,000	Capital	56,000
Debtors	20,500	Creditors	40,000
Furniture	13,000		
Machinery	25,000		
Opening stock	15,000		
Rent	4,500		
Wages	11,000		
Insurance	1,000		
Carriage outwards	2,000		
Travelling expenses	1,000		
Bills receivable	34,000		
Salaries	8,000		
Drawings	6,000		
	----------		----------
	2,46,000		**2,46,000**
	=======		=======

Adjustments:
1. Closing stock stock Rs.32,000
2. Write off Bad debts Rs.500
3. Provide 5/- provision for Doubtful debts
4. Outstanding wages Rs.1,000
5. Provide Depreciation on furniture 10% and on Machinery 10%

Section E

Answer any ONE of the following questions **1 x 10 = 10**

19. Prepare three column cash book of Renish from the following particulars.

2012 March

1^{th}	Cash in Hand	Rs.25000
	Cash at Bank	Rs.10000
3^{rd}	Purchases	Rs.1000
5^{th}	Sold goods for cash	Rs10000
6^{th}	Paid cash to Sailu	Rs.675
	and discount received	Rs.25
10^{th}	Deposited cash in to Bank	Rs.2000
14^{th}	Received cash from Suchi	Rs.850
	and discount allowed	Rs.150
18^{th}	Received cheque from Kiran	Rs.1500
	and deposited the cheque in the Bank on the same day	
26^{th}	Paid rent by cheque	Rs.1000
31^{st}	Received Commission	Rs.500

20. On 31-12-2012 Mr. Sarath Kumar's bank balance as per pass book Rs.6000. There is dis agreement between cash book and pass book balance. Prepare Bank reconciliation statement by considering following transactions:

a)	Cheque deposited for collection, but not yet realised	Rs.1200
b)	Cheque issued but not yet presented for Payment	Rs.2000
c)	Bank charges debited in pass book only	Rs.90
d)	Bank paid insurance as per standing orders	Rs.400
e)	Directly deposited by a customer in to bank	Rs.3000
f)	Interest credited in pass book only	Rs.120

Section F

Answer any TWO of the following questions **2 x 5 = 10**

21. Explin any five advantages of Book keeping
22. Prepare X & Co., from the following transactions

2012 June

1st	Amount due to X & Co	Rs.4000
2rd	Goods purchased from X & Co	Rs.10000
5th	Cash paid to X & Co.	Rs.4,000
9th	Goods returned to X & co.	Rs.500
14th	Paid to X & Co. by cheque	Rs.5000
21st	Cash purchases from X & co	Rs.2000

23. Enter the following transactions in the proper Subsidiary Books

2012 Nov

1st	Purchases from Sarasu	Rs.3000
2nd	Purchased goods from Kittu	Rs.4000
3rd	Sold goods to Pavani	Rs.5000
4th	Sold goods to Ramanji	Rs.1500
5th	Purchased from Srinivas	Rs.2000
6th	Sold goods for cash to Rohithia	Rs.1500

24. Explain the various types of Errors

Section G

Answer any FIVE of the following questions **5 x 2 = 10**

25. Debtors
26. Suspense a/c
27. Outstanding expenses
28. Mention the rule of Debit and Credit of Real a/c
29. Contra entry

30. Journalise the following transactions

Nov

1st	Started business with Cash	Rs.1000
4th	Paid wages	Rs.10000
6th	Goods purchased from sushmitha	Rs.3000
8th	Sold goods for cash	Rs.3000

31. Write opening entries from the following

Cash in hand	Rs.1000
Cash at Bank	Rs.3000
Debtors	Rs.10000
Creditors	Rs.5000
Buildings	Rs.20000
Bills payable	Rs.5000
Furniture	Rs.6000

32. Prepare Trial Balance from the following particulars as on 31-12-2012

	Rs.
Bills Payable	3000
Purchases	5000
Sales	10000
Sales returns	2000
Purchase returns	1000
Furniture	15000
Bills receivable	4000
Capital	12000