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Note: The study material of this subject has been updated and converted into SIM format by Dr. B.S. Bodla, Professor, Department of Business Management, Guru Jambheshwar University of Science and Technology, Hisar (Haryana).

Subject : Business Flow System

Course Code : MCA-104

Lesson : 1

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THE NATURE AND COMPONENTS OF BUSINESS

STRUCTURE

- 1.0 Objectives
- 1.1 Introduction
- 1.2 Nature of business
- 1.3 Risk and uncertainty
- 1.4 Objectives and importance of business
- 1.5 Professionalisation
- 1.6 Business ethics
- 1.7 Scope of business
- 1.8 Commerce
- 1.9 Commercial activities
 - 1.9.1 Trade
 - 1.9.2 Aids of trade
- 1.10 Difference between Industry, Commerce and Trade
- 1.11 Business organisation
- 1.12 Functional Areas of Business
- 1.13 Summary
- 1.14 Keywords
- 1.15 Self assessment questions
- 1.16 References/suggested readings.

1.0 OBJECTIVES

After reading this lesson, you will be conversant with

- Concept, Objectives and nature of business
- Classification of business activities into Industry and Commerce
- Trade, aids to trade and types of trade
- Various functional areas of business

Subject : Business Flow System	Author : Dr. B.S. Bodla
Course Code : MCA-104	Vetter : Prof. M.S. Turan
Lesson : 2	
ENVIRONMENT OF BUSINESS SYSTEM	

STRUCTURE

- 2.0 Objectives
- 2.1 Introduction to business environment
- 2.2 Importance of the study of business environment
- 2.3 Economic and non-economic environment
- 2.4 Components of environment
- 2.5 Internal environment
- 2.6 Business and economic systems
- 2.7 Summary
- 2.8 Keywords
- 2.9 Self-assessment questions
- 2.10 References/suggested readings

2.0 OBJECTIVES

The objectives of this lesson are :

- to explain the meaning and definition of business environment;
- to explain the importance of the study of business environment;
- to discuss various components of internal and external environment; and
- to describe main features of various economic systems.

2.1 INTRODUCTION TO BUSINESS ENVIRONMENT

Business enterprise is a part of society and the business environment has direct relationship with the policy of the enterprise. The environment may impose several constraints on the enterprise. The enterprise on the other hand, has very little control over its environment. Therefore, the success of an enterprise depends to a very large

extent on its adaptability to the environment, i.e., its ability to identify itself with the environment and fit in with the environmental framework. According to Hicks, "The firm can adjust to the environment, or if it has ability, change the environment."

Business environment can be classified into two parts- the economic environment; and the non-economic environment. The economic environment consists of factors like fiscal policy, monetary policy, economic policy, industrial and licensing policy, factors of production, the pace of economic development, etc. The non-economic environment refers to social, cultural and political, legal, technological factors, etc.

Environment literally means the surrounding external objects, influences of circumstances under which someone or something exist. The environment of any organisation is " the aggregate of all conditions, events and influences that surround and affect". Business environment exhibits many characteristics since it is complex, dynamic, multifaceted and it has far reaching impact. For all these reasons dividing environment into external and internal components enables us to understand it better. Every business enterprise thus consists of a set of internal factors and is confronted with a set of external factors.

A conscious identification of the relevant environment enables the organisation to focus its attention on those factors which are initially related to its mission, purpose, objectives and strategies. Depending on its perception of the relevant environment, an organisation takes into account those influences in its surroundings which have an immediate impact on its strategic management process. Having identified its relevant environment, an organisation can systematically appraise it and incorporate the results of such an appraisal in strategic planning. The environment of business is an extremely complex and dynamic phenomenon

as the environmental factors vary from country to country. In order to cope with the complexity of the environment it is feasible to divide it into different components and sectors.

2.2 IMPORTANCE OF THE STUDY OF BUSINESS ENVIRONMENT

Before analysing the various external environmental factors, let us consider the importance of the study of the business environment :

1. The study of the business environment helps an organisation to develop its broad strategies and long-term policies.
2. It enables an organisation to analyse its competitors' strategies and thereby formulate effective counter strategies.
3. Knowledge about the changing environment will keep the organisation dynamic in its approach.
4. Such a study enables the organisation to foresee the impact of the socio-economic changes at the national and international level on its stability.
5. Finally, as a result of the study, executives are able to adjust to the prevailing conditions and thus influence the environment in order to make it congenial to business.

2.3 ECONOMIC AND NON-ECONOMY ENVIRONMENT

Business environment can be classified into two major categories: the economic environment and the non-economic environment. The economic environment consists of factors like the fiscal policy, the monetary policy, the industrial policy, the physical limits on output, the price and income equation, nature of the economic system, the pace of the economic development, etc.

The non-economic environment refers to social, cultural and political, legal, technological factors, etc. Despite this segregation, the economic environment has economic implications. In today's business environment, considerable skill and dexterity is required in adjusting, coping with and managing the environment of business. This becomes more so due to the changing nature of today's business context.

2.4 COMPONENTS OF ENVIRONMENT

The classification of relevant environment into components or sectors helps the organisation to cope with its complexity, comprehend the different influences operating and relating the environmental changes to its strategic management process. A variety of relevant factors in the environment have to be considered, such as the size of organisation level and scope of a variety of activities, geographical spread of markets, nature of products, type of technology used and managerial philosophy. An organisation may divide its relevant environment into components capable of being analysed conveniently. There are seven categories of classification of environment-social, political, economic, regulatory, market, supplier and technological. The business enterprise consists of a set of external factors and is confronted with a set of internal factors. The internal factors are generally regarded as controllable factors because companies have control over these factors. It can alter or modify such factors as their personal, physical facilities, organisation and functional means, such as the marketing mix to suit the environment.

External factors, on the other hand are by and large beyond the control of the company. For example factors such as the economic factors, socio-cultural factors, government and legal factors, geographical and demographic factors, etc. They are therefore generally regarded as uncontrollable factors.

2.4.1 Socio-Cultural Environment

The socio-cultural fabric is an important environmental factor that should be analysed while formulating business strategies. The cost of ignoring the customs, traditions, taboos, tastes and preferences, etc., of a people could be very high.

The buying and consumption habits of the people, their language, beliefs and values, customs and traditions, tastes and preferences, deduction are all factors that affect business.

For a business to be successful, its strategy should be the one that is appropriate in the socio-cultural environment. The marketing mix will have to be so designed as best to suit the environmental characteristics of the market. In Thailand, Helene Curtis switched to black shampoo because Thai women felt that it made their hair look glossier. Nestle, a Swiss multinational company, today brews more than forty varieties of instant coffee to satisfy different national tastes.

Even when people of different cultures use the same basic product, the mode of consumption, conditions of use, purpose of use or the perceptions of the product attributes may vary so much so that the product attributes, method of presentation, positioning, or method of promoting the product may have to be varied to suit the characteristics of different markets. For example, the two most important foreign markets for Indian shrimp are the U.S. and Japan. The product attributes for the success of the product in these two markets differ. In the U.S. market, correct weight and bacteriological factors are more important rather than eye appeal, uniformity of size and arrangement of shrimp which are very important in Japan. Similarly, the mode of consumption of tuna, another seafood export from India, differs between the U.S. and European countries . Tuna fish sandwiches, an American favourite which accounts for about 80 per cent of American tuna consumption, have little appeal in high tuna consumption European countries

where people eat it right from the can. A very interesting example is that of the Vikas Vaporub, the popular pain balm, which is used as a mosquito repellent in some of the tropical areas.

The differences in language sometimes pose a serious problem, even necessitating a change in the brand name. Preett was, perhaps, a good brand name in India; but it did not suit in the overseas market; and hence it was appropriate to adopt 'Prestige' for the overseas markets.. Chevrolet's brand name 'Nova' in Spanish means "it doesn't go". In Japanese, General Motors "Body by Fisher" translates as "corpse by Fisher". In Japanese, again, 3M's slogan "sticks like crazy translates as "sticks foolishly". In some languages, Pepsi-Cola's slogan "come alive" translates as "come out of the grave."

The values and beliefs associated with colour vary significantly between different cultures. Blue, considered feminine and warm in Holland, is regarded as masculine and cold in Sweden. Green is favourite colour in the Muslim world; but in Malaysia, it is associated with illness. White indicates death and mourning in China and Korea; but in some countries, it expresses happiness and is the color of the wedding dress of the bride. Red is a popular colour in the communist countries; but many African countries have a national distaste for red colour.

Social inertia and associated factors come in the way of the promotion of certain products, services or ideas. We come across such social stigmas in the marketing of family planning ideas, use of bio-gas for cooking, etc. In such circumstances, the success of marketing depends, to a very large extent, on the success in changing social attitudes or value systems.

2.4.2 Demographic Environment

Demographic factors like the size, growth rate, age composition, sex composition, etc. of the population, family size, economic stratification of the population,

educational levels, language, caste, religion etc. are all factors which are relevant to business.

Demographic factors affect the demand for goods and services. Markets with growing population and income are growth markets. But the decline in the birth rates in countries like the United States have affected the demand for baby products. Johnson and Johnson have overcome this problem by repositioning their products like baby shampoo and baby soap, promoting them also to the adult segment, particular to the females.

A rapidly increasing population indicates a growing demand for many products. high population growth rate also indicates an enormous increase in labour supply. When the Western countries experienced the industrial revolution, they had the problem of labour supply, for the population growth rate was comparatively low. Labour shortage and rising wages encourage the growth of labour-saving technologies and automation. But most developing countries of today are experiencing a population explosion and a situation of labour surplus. The governments of developing countries, therefore, encourage labour intensive methods of production. Capital intensive methods automation and even rationalization are opposed by labour and many sociologists, politicians and economists in these countries. The population growth rate, thus, is an important environmental factor which affects business. Cheap labour and a growing market have encouraged many multinational corporations to invest in developing countries.

If labour is highly heterogeneous in respect of language, caste and religion, ethnicity, etc. personnel management is likely to become a more complex task. The heterogeneous population with its varied tastes, preferences, beliefs, temperaments, etc. gives rise to differing demand patterns and calls for different marketing strategies.

References to a number of demographic factors that have business implications have already been made under "socio-cultural environment."

2.4.3 Natural Environment

Geographical and ecological factors, such as natural resource endowments, weather and climatic conditions, topographical factors, vocational aspects in the global context, port facilities, etc., are all relevant to business.

Differences in geographical conditions between markets may sometimes call for changes in the marketing mix. Geographical and ecological factors also influence the location of certain industries . For example, industries with high material index tend to be located near the raw material sources. Climatic and weather conditions affect the location of certain industries like the cotton textile industry. Topographical factors may affect the demand pattern. For example, in hilly areas with a difficult terrain, jeeps may be in greater demand than cars.

Ecological factors have recently assumed great importance. The depletion of natural resources, environmental pollution and the disturbance of the ecological balance have caused great concern. Government policies aimed at the preservation of environmental purity and ecological balance , conservation of non-replenishable resources, etc., have resulted in additional responsibilities and problems for business, and some of these have the effect of increasing the cost of production and marketing. Externalities have become an important problem the business has to confront with.

2.4.4 Technological Factors

Technology has been defined "as a systematic application of scientific or other organised knowledge to practical tasks." It includes inventions and innovations. It affects the manner in which the resources of the economy are converted into

output. Technological changes affect production methods , processes and the raw materials used in the manufacture of a product.

Technological changes may enable a firm to achieve its objectives or threaten the existence of the firm. A firm which is not able to cope with changing technology may not survive. Fast changes in technological factors can create problems as they render plants and products obsolete very quickly. However, all sectors of the economy are not equally affected by technological changes. Some sectors are more volatile than others. For example, air craft industries and pharmaceutical industries are more volatile than furniture and textile industries. Hence, strategists in industries which are subject to volatile changes should be more alert to changes than those in more stable industries.

2.4.5 International Environment

The international environment is very important from the point of view of certain categories of business. It is particularly important for industries directly depending on imports or exports and import-competing industries. For example, a recession in foreign markets, or the adoption of protectionist policies by foreign nations, may create difficulties for industries depending on exports. On the other hand, a boom in the export market or a relaxation of the protectionist policies may help the export-oriented industries. A liberalisation of imports may help some industries which use imported items, but may adversely affect import-competing industries.

It has been observed that major international developments have their effects on domestic business. The Great depression in the United States sent its shock-waves to a number of the countries. Oil price hikes have seriously affected a number of economies. These hikes have increased the cost of production and the prices of certain products, such as fertilizers, synthetic fibres, etc. the high oil

price has led to an increase in the demand for automobile models that economise energy consumption. The demand for natural fibres increased because of the crisis.

2.4.6 Supplier Environment

The supplier environment occupies a dominant position in strategy formulation. This is understandable that India is a developing country having problems of scarcity of capital and appropriate raw material sources. Almost all annual company reports lament the shortage of power and cite the high costs of raw materials as the reason for low profitability. Let us consider an illustration to highlight the importance of the supplies environment :

Power shortage affect industry considerably. The seven most energy intensive industries in India are cement, aluminum, fertilizers, petrochemicals, pulp and paper, refineries and steel. Considering the case of mini steel plants, we find that their viability is critically dependent on the cost and availability of power, as nearly 15per cent of the total manufacturing costs are accounted for by power. It is mainly used in electric arc furnaces for both melting and refining scrap for steel manufacturing. Alternative sources of power supply like generating sets are not economical to use in mini steel plants as large volumes of power are required.

2.4.7. Political Environment

The political environment consists of factors related to the management of public affairs and their impact on the business of an organisation. Political environment has a close relationship with the economic system and the economic policy. For example, communist countries have a centrally planned economic system. In most countries apart from those laws that control investment and related matters, there are a number of laws that regulate the conduct of the business. These laws cover such matters as standard of product, packaging, promotion, etc.

Some governments specify certain standards for the products including packaging. Some other governments prohibit the marketing of certain products. In most nations promotional activities are subject to various types of controls. In number of countries including India, the advertisement of alcoholic is prohibited. Advertisements including packaging of cigarettes must carry the statutory warning that " Cigarette smoking is injurious to health". Similarly advertisement of baby food must necessarily inform the potential buyer that breast feeding is the best food for an infant. There are a host of statutory controls on business in India. If the MRTP companies desire to expand their business substantially, they have to convince the government that such expansion is in the public interest.

Government in India has an all pervasive and predominantly restrictive influence over various aspects of business, for example, industrial licensing which decides location, capacity and process, import licensing for machinery and material, size of capital issue, loan finance, pricing, managerial remuneration, expansion plans, distribution, restrictions and a host of other enactments. In India, the monopolistic undertakings and large industrial houses are subject to a number of regulations which restrict the concentration of economic power to the common determinant. The MRTP Act also controls and restricts monopolistic trade practices which are prejudicial to public interest. Such regulations brighten the prospects of small and new firms and increase the scope of some of the existing firms to venture into new areas of business. The special privileges available to the small scale sector have contributed to the phenomenal success of "Nirma".

Our's is a democratic country having a stable political system where the government plays an active role as a planner, promotor and regulator of economic activity. Businessmen, therefore, are conscious of the political environment that their organisation face. Most governmental decisions related to business are based on

political considerations in line with the political philosophy followed by the ruling party at the centre and the state level.

2.4.8 Economic Environment

The economic environment consists of macro level patterns related to the areas of production and distribution of wealth that have an impact on the business of an organisation. Some of the important factors and influences operating in economic environment are :

1. Economic stages existing at a given time in a country.
2. The economic structure adopted such as capitalistic, socialistic or mixed economy.
3. Economic planning, such as 5-years plans, annual budgets, etc.
4. Economic policies, such as industrial, monetary and fiscal policies.
5. Economic indices like national income, distribution of income, rate of growth and growth of GNP, per capita income, disposable personal income, rate of saving, investment value of imports and exports, balance of payments, etc.
6. Infrastructural factors such as financial institutions, banks, modes of transportation, communication facility, energy sources, etc.

Strategists are acutely aware of the importance and impact of the economic environment on their organisations. Almost all annual company reports presented by the Chairman devote attention to the general economic environment prevailing and the specific aspects that have an impact on their organisation and the business they are in. Some examples highlighting the role of economic environment are discussed below :

(i) The process of liberalisation of the economy since past 10 years has had a mixed effect on Indian industry. While most of the companies have benefited in terms of the resulting freedom to alter product mix and capacity, there have been some adverse affects too in the areas of overcapacity and increased competition. Partial decontrol of cement in 1982 led to a rapid increase in production capacity and resultant supply, changing the market situation from that of acute scarcity to a comfortable surplus. Liberalisation of imports has led to increased competition in the capital goods industries causing profits to decline as a result of which many companies have not been able to sustain their business.

(ii) In India, public savings have been traditionally invested in fixed assets and precious metals. The share of savings invested with the Government has been channeled through post-offices and banks. However, of late the investors have increasingly turned to other avenues like stock markets and company deposits. Recent changes in economic and fiscal policies have led to many significant developments. Leasing and financing companies, public sector bonds' mutual funds, venture capital business, newer financial instruments, entry of banks and financial institutions in stock trading are some of the developments which provide the resources for capital market and project financing.

The economic policy of the government needless to say has a very great impact on business - some categories of business are favourably affected by the government policy, some are adversely affected while some others remain natural. For example, a restrictive import policy a policy of protecting the home industries may greatly comfort indigenious industries while liberalisation of the import policy may create difficulties for such industries.

Analogously, an industry that falls within the priority sectors in terms of the government policy may get a number of incentives and other positive support from the government whereas those industries which are regarded inessential may have the odds against them.

The monetary and fiscal policies by the incentives and disincentives they offer and by their neutrality also affect the business in different ways. An industrial undertaking may be able to take advantage of the external economies by locating itself in large cities but the Government of the India's policy is to discourage industrial location in such places and constrain and persuade industries to go to the backward areas. From the point of view of an industrial undertaking, a backward area location may have many disadvantages. However, the incentives available for units located in these backward areas may compensate them for these disadvantages at least to some extent.

The economic system thus is a very important determinant of the scope of private business and is therefore a very important external constraint on business.

2.4.9 Regulatory Environment

The regulatory environment encompasses the factors related to the planning, promotion and regulation of economic activities by the government that have an impact on the business of an organisation. Some of the important factors and influences operating in the regulatory environment are as follows :

- (a) Policies related to control over distribution and pricing.
- (b) Imports and exports policies.
- (c) The Constitutional framework, Directive principles, Fundamental rights and divisions of legislative power between Central and State Governments.

- (d) Policies related to licensing monopolies, foreign investment and financing of industries.
- (e) Other policies related to the public sector, small-scale industries, sick industries, development of backward areas, control of environmental pollution and customer protection.

As our economy is centrally planned and controlled, the principle of regulation of economic activities by public authorities in the larger interests has taken roots. Business and industry operate within a regulatory environment. The relationship between industry and the regulatory environment exists as a two-ways process. The government lays down the policies, procedures and rules according to which the industry functions.

There are a number of administrative controls over business that are exercised through the regulatory mechanism. Some of the important business laws in operation are :

- a. Monopolies and Restrictive Trade Practices' Act;
- b. Indian Companies Act 1956;
- c. Securities Contract Act Regulation Act (SCRA);
- d. Securities Exchange Board of India (SEBI);
- e. Export-Import Policy (1997-2002);
- f. Foreign Exchange Management Act;
- g. Industries Development and Regulation Act;
- h. Sale of Goods Act
- i. Consumer Protection Act;
- j. Income Tax and Sale Tax, Laws

2.5 INTERNAL ENVIRONMENT

A brief description of the factors related to internal environment is discussed as follows :

2.5.1 Financial Strength

Financial factors relate to the availability, usage and management of funds and all allied aspects that have a bearing on an organisation's capacity and its ability to implement its strategies. Some of the important factors which influence the financial capability of any organisation area are as follows :

1. Financial factors related to the sources of funds like capital structure, procurement of capital, controllership, financing pattern, working capital availability, borrowings, capital and credit availability, reserves and surplus and relationship with lenders, banks and financial institutions.
2. Financial factors about uses of funds, capital investment, fixed assets acquisition, current assets, loans and advances, dividend distribution and relationship with shareholders.
3. Factors related to management of funds like financial accounting and budgeting, management control system, state of financial health, cash, inflation, credit, return and risk management, cost reduction and control & tax planning and control its advantages.

Based on the above factors, a number of strengths and weaknesses can be found that affect the financial capability of an organisation. The absence or unavailability of these factors leads to the occurrence of weaknesses.

The examples given below show how strengths and weaknesses can be found that affect the financial capability of an organisation. The absence or unavailability of these factors leads to the occurrence of weaknesses.

a. The majority of companies have to keep their fixed deposit schemes open for months to collect the requisite amounts from the general public. But Hindustan Cocoa Products, the manufacturer of Cadbury's brand of chocolates, collected the permissible amount of fixed deposits in less than a week of opening its collection scheme in late 1987. Such a high level of investor confidence is a great strength and helps to build financial capability.

b. Another example of a company which enjoys a high level of investor confidence is Reliance Textiles Ltd. Its subsidiary, Reliance private sector company in India in August, 1988 and in the process created several records. Access to public money as an advantage since it is the cheapest form of financing available.

2.5.2 Marketing Factors

The marketing factors related to the pricing, promotion and distribution of products or services and all the allied aspects that have a bearing on an organisation's capacity and ability to implement its strategies play an important role. Some of these important factors which influence the marketing capability of an organisation includes product differentiation, product mixed, product quality, brand positioning, packaging, product pricing objective and policies, sales promotion, advertising, public-relations, marketing mix, distribution system, market standing, company image, marketing organisation, marketing system, marketing management, information system, etc.

2.5.3 Operations Capability Factors

These factors relate to the production of goods or services, use of material resources and all allied aspects that have a bearing on an organization's capacity and ability to implement its strategies. Some of the important factors which influence operations capability of an organisation are as follows : production

capacity, location, layout, product or service design, work system, degree of automation, extent of vertical integration, aggregate production planning, material supply, inventory, cost and quality control, maintenance system and procedure, personnel facilities, product development, patent right, level of technology used, technical collaboration and support, etc.

2.5.4 Strengths of General Management

Strengths about general management pertain of the capability of integration, coordination and direction. Broadly, strategic management system, process related to mission, purpose and objective setting, strategy formulation and implementation machinery, strategy evaluation system, management information system, corporate planning system, rewards and incentives system for top managers, etc. are some of the important factors which influence the general management capability of an organisation.

2.6 BUSINESS AND ECONOMIC SYSTEMS

The scope of private business and the extent of government regulation of economic activities depend to a very large extent on the nature of the economic system, which is an important part of the business environment. The following pages of this lesson are intended to provide an outline of the general features of the broadly distinctive economic systems.

2.6.1 Capitalism

The capitalist system is one characterized by the private ownership of the means of production, individual decision making, and the use of the market mechanism to carry out the decision of individual participants and facilitate the flow of goods and services in markets. The capitalist system is also known as free enterprise economy and market economy.

Two types of capitalism may be distinguished as follows :

- (i) The old, laissez-fairl capitalism, where government intervention in the economy is absent or negligible; and
- (ii) The modern, regulated or mixed capitalism. where there is a substantial amount of government intervention.

Features : The principal characteristics of a "pure" capitalist system are :

- (i) **Private Ownership :** In a capitalist economy, the factors of production - land, labour and capital - are privately owned, and production occurs at private initiative. Individuals have their property rights protected and are usually free to use their property as they like as long as they do not infringe on the legal property rights of others. Private property, however, is protected, controlled and enforced by law.
- (ii) **Free Enterprise :** Free enterprise, an essential feature of the capitalist system, is merely an extension of the concept of property rights. The term free enterprise implies that private firms are allowed to obtain resources, to organise production and to sell the resultant product in any way they choose.
- (iii) **Consumer's Sovereignty :** Consumer's sovereignty is at its best in the capitalist system where consumers have complete freedom of choice of consumption.
- (iv) **Freedom of Choice of Occupation :** In a capitalist economy, the individual is free to chose any occupation he is qualified for. This freedom of choice enables the worker to make the best possible bargain for his labour. This implies the employers have to competitively bid for labour.
- (v) **Freedom to Save and Invest :** The freedom to save is implied in the freedom of consumption, for savings depend on income and consumption. The term saving implies the sacrifice of consumption.

(vi) **The Market System** : The market mechanism is the key factor that regulates the capitalist economy. A market economy is one in which buyers and sellers express their opinions about how much they are willing to pay for or how much they demand of goods and services. Prices guide the purchase decisions of the consumers. At the same time, while they decide to buy or not to buy a product, consumers vote for or against the product by using their money. Thus, market prices, which reflect the desires of millions of consumers, provide guidance to investors and other business persons. The market system, also called the price system, may, therefore, be regarded as the organising force in a capitalist economy.

(vii) **Competition** : Competition among sellers and buyers is an essential feature of an ideal capitalist system. Competition reduces market imperfections and associated problems. Therefore, in a free market economy, "a sufficient amount of competition is considered necessary if the whole production and distribution process is to be regulated by market forces. Competition is necessary in a private enterprise economy to keep initiative constantly on alert, to protect the consumer, and to maintain a sufficiently flexible price system.

2.6.2 Modern Capitalism

Modern capitalist economies are mixed or regulated systems. Such regulated capitalist or market economies include the United States, Canada, Australia, the United Kingdom, France, Italy, the Federal Republic of Germany, Japan, Spain, New Zealand, the Netherlands, Belgium, Denmark, Sweden, Switzerland, Norway, etc.

Evaluation of Capitalism

Pure capitalism is an idealised system. It is very difficult to realise the avowed virtues of a free enterprise economy in the real world. There is no invisible

hand that ensures the smooth functioning of the capitalist system.

Unregulated capitalism suffers from certain drawbacks.

(i) As investment allocation is guided by the profitability criterion, sufficient investment may not take place in areas where profitability is low, however, essential they may be.

(ii) The right to property and freedom of enterprise are likely to lead to concentration of income and wealth and the widening of interpersonal income disparities.

(iii) Though, according to the theory, there will be free competition, in the real world the large firms are likely to gain an advantageous position which would eventually lead to monopolies.

Because of these defects of pure capitalism, modern capitalist economies are regulated systems. In such regulated capitalist economies, not only does the state regulate private enterprise but often set up enterprises either to supplement the activities of private enterprise or to offer an effective competition to the private sector.

2.6.3 Socialist Systems

The salient features of a socialist system are :

(i) **Government Ownership/Control :** In socialist countries, the major means of production are either owned by the Government or their use is controlled by the Government. In a communist country like China, the means of production are owned by the State.

(ii) **Central Authority :** The socialist economies generally have a central authority like the central planning agency to formulate the national plan for development and to direct resource mobilisation, allocation and investment to

achieve the plan targets.

(iii) **Restriction on Consumption :** In communist countries, there is no consumer sovereignty because the state decides what may be made available to consumers, unlike in the market economies where the consumers have the freedom to choose from a wide variety.

(iv) **Restriction on Occupation :** The freedom of occupation is absent or restricted in socialist countries. An individual may not have the freedom to choose any occupation he is qualified for. Similarly, individual freedom of enterprise is absent or regulated.

(v) **Fixation of Wages and Prices :** The wage rates and prices in a communist economy are fixed by the Government and not by market forces. Non-communist socialist countries may also fix wages and prices or regulate them by certain means.

(v) **Distribution of Income :** An equitable distribution of income is an important feature of the socialist system. This does not mean, however, that socialist systems aim at perfect equality in income distribution. Wage differentials, depending on the nature and requirements of the job, are recognised in socialist countries.

2.6.4 Market Socialism

"Market socialism is characterized primarily by the public ownership of the means of production. Decisions with reference to the allocation of resources are made both collectively and by individual producing and consuming units. Prices and markets are the primary mechanisms used to facilitate the exchange of products". The Yugoslav economy contains many of the elements of market socialism.

2.6.5 Evaluation of Socialism

Socialism has become a very appealing and flexible concept. It has been aptly remarked that socialism is a cap that has lost its shape because so many different people have worked on it. Indeed, there is a large variety of socialism today.

Democratic socialism strives to achieve a trade-off between the free enterprise system and state capitalism. Communism and state capitalism, however, suffer from a number of drawbacks. Some of the important among these are the following :

- (i) Civil liberties are suppressed under communism.
- (ii) There is no consumer sovereignty in socialist systems.
- (iii) The central planning authority commands the resource allocation investment and development pattern.
- (iv) As private enterprise is not allowed to operate, the resources of the nation are not fully utilised.
- (v) People may lack incentive to work hard in the absence of private property.

Because of the drawbacks of the totalitarian socialism mentioned above, a number of socialist systems today are mixed systems where we have both private enterprise regulated by the state and state enterprise.

2.6.6 Mixed Economy

The mixed economy, which shares certain features of private capitalism and state capitalism, is characterized by the co-existence of public and private sectors and the overall government regulation of the economy. The primary difference between the mixed economy and market socialism is the relatively greater importance of individual decision-making, private property, and the

reliance on market determined prices to guide the allocation of resources. The mixed economy differs from competitive capitalism with respect to the share of collective decision-making in the economy.

2.7 SUMMARY

The environment in which an organisation exists could be broadly divided into two parts : external and internal environment. We began by giving an understanding of the concept of environment. This is done through a description of four important characteristics of the environment leading its external and internal parts.

We see how the external environment, specially that part which is more relevant to an organization can be divided into different components. For the purpose of understanding and analysis we have discussed many components of the external environment - social, political, economic, regulatory, market, supplier and technological. For each component we have explained through appropriate illustrations, the type of factors and influences which operate in that part of the environment. The significance of these factors for the strategic management of the organisation has also been highlighted.

Organisational strategic capability could be understood in terms of strengths and weaknesses existing in the different functional areas of an organisation. We have considered five such areas - finance, marketing, operations, personnel and general management. For each of these, we have mentioned the important factors influencing them and through examples clarified the nature of the various functional capability factors.

Environmental analysis is a crucial part of the strategic management process. If the environment is ignored (or partially ignored) by strategic decision makers, the process cannot be effective. Effective strategists try to anticipate

what is coming or attempt to influence the environment in favourable directions.

The environmental strategic analyst interrelates with the formation of objectives, the generation of alternative strategies and the other aspects of strategic management.

2.8 KEYWORDS

Business environment: Environment of any business firm refers to the aggregate of all conditions, events and influences that surround and affect it.

Economic environment: It consists of factors like fiscal policy, monetary policy, economic policy, industrial and licensing policy, factors of production, the pace of economic development, export policy, etc.

Non-economic environment: It refers to social, cultural, political, legal, technological factors surrounding or affecting an entity/firm.

Technology: A systematic application of scientific or other organized knowledge to practical task.

Regular environment: It encompasses the factors related to the planning, promotion and regulation of economic activities by the government that have an impact on the business of an organization, for instance, Directive Principles and Fundamental Rights given in the Constitution of India.

Capitalism: The capitalist system is one characterized by the private ownership of the means of production, individual decision-making, and the use of the market mechanism to carry out the decision of individual participants and facilitates the flow of goods and services in markets.

Socialist system: In this system, the major means of production are either owned by the government or their use is controlled by the government and these economies have a central authority like the Central Planning Agency to formulate the national plan for development and to direct resource

mobilization, allocation and investment to achieve the plan targets. Here, freedom of occupation is a restricted and equitable distribution of income is an important features.

Mixed economy: The economy which shares certain features of private capitalism and state capitalism. It is characterized by the co-existence of public and private sector and the overall governmental regulation of the economy.

2.9 SELF ASSESSMENT QUESTIONS

1. Define business environment. What are the various facets of business environment?
2. Define "business environment" and state the importance of its study.
3. 'Business environment is dynamic. Discuss.
4. How does political environment influence the business policy of an organisation?
5. What are the economic factors affecting business policies?
6. How does the socio-cultural environment influence the business policy of an organisation ?
7. Is business environment static ? Discuss.
8. Describe the various external factors that influence the business policy of an organisation.
9. Explain the various internal factors that influence business policies.

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SOLE PROPRIETORSHIP AND PARTNERSHIP

STRUCTURE

- 3.0 Objectives
- 3.1 Introduction
- 3.2 Sole Proprietorship
- 3.3 Partnership Firm
- 3.4 Joint Hindu Family Business
- 3.5 Co-operative Organisation
- 3.6 Summary
- 3.7 Keywords
- 3.8 Self Assessment Questions
- 3.9 References/Suggested Readings

3.0 OBJECTIVES

After reading this lesson, you should be able-

- (a) to discuss the meaning and features of Sole Proprietorship form of business organisation;
- (b) to explain advantages, disadvantages and survival of sole proprietorship form of business organisation;
- (c) to describe characteristics and procedure for formation of partnership form of organisation;
- (d) to discuss the procedure for registration and dissolution of partnership firms;
- (e) to bring out advantages, disadvantages and suitability of partnership form of business organisation; and
- (f) to explain meaning and characteristics of Joint Hindu Family form of business organisation.

3.1 INTRODUCTION

An important decision which an entrepreneur has to make is the legal structure of his enterprise. This decision is important because the choice of ownership form affects the rights, duties, obligations of owners size of business as well as the tax liability. Several structural alternatives are available from which the choice can be made. The important forms of business organisations in the private sector are as follows :

- (i) Sole Proprietorship;
- (ii) Joint Hindu Family Firm;
- (iii) Partnership Firm;
- (v) Cooperative Organisation.
- (iv) Joint Stock Company; and

The first three (namely, Sole Proprietorship, Joint Hindu Family Business and partnership firm) may be categorised as non-corporate and the remaining two (namely, joint stock company and cooperative enterprises) as corporate forms of organisations. The essential distinction between these two categories is that a non-corporate form of business may be started without legal formalities while a corporate body can be launched and run only after fulfilling the legal formalities as prescribed under the laws governing their functioning. The non-corporate forms of organisations are discussed in this chapter.

3.2 SOLE PROPRIETORSHIP

Sole proprietorship or individual entrepreneurship is a business concern owned and operated by one person. The sole proprietor is a person who carries on business exclusively by and for himself. He alone contributes the capital and skills and is solely responsible for the results of the enterprise. In fact sole proprietor is the

supreme judge of all matters pertaining to his business subject only to the general laws of the land and to such special legislation as may affect his particular business.

3.2.1 Features of Sole Proprietorship

(i) **Single Ownership :** It is owned by one individual. It is run entirely at his risk of loss. The sole trader provides both capital and management to the business.

(ii) **Personal Organisation or Common Identity :** It has no separate legal identity independent of the owner. The owner and the business concern are one and the same. The owner owns everything the business owns and he owes everything the business owes.

(iii) **Unlimited Liability :** The liability of the proprietor for the debts of the business is unlimited. The creditors have the right to recover their dues even from the personal property of the proprietor in case the business assets are not sufficient to pay their debts.

(iv) **One Man Control :** Sole proprietorship is one man show. The sole proprietor manages the business. He takes all the decisions, procures material resources, employs persons, provide direction and controls the affairs of the enterprise. He is not required to consult anyone else in taking any decision. Though the sole trader may delegate some of his authority to his assistants but the ultimate authority to manage and control rests with him.

(v) **Profits and Losses :** The surplus arising in the business of the sole proprietor, entirely belongs to him and similarly all the business losses and risks are to be borne by him alone.

3.2.2 Advantages of Sole Proprietorship

(i) **Ease of Formation :** The establishment of a sole proprietorship concern is easier as compared to other forms of organisation. A person with small amount of capital can start the business without undergoing much legal formalities.

Procurement of licence may be a necessity to deal in particular commodities like drugs, liquor, food grains, etc.

(ii) **Flexibility :** The sole proprietor is free to change the nature and scope of his business operations, whenever the situation demands. The flexibility is available because the sole trader is the sole owner of the business.

(iii) **Quick Decisions :** Sole proprietorship concern facilitates quick decision making and prompt action. Exclusive control and direction of the proprietor results in increased efficiency, production of quality products and reduction of costs. Since the owner is the 'supreme judge' in all matters pertaining to his business, he can take quick decision and implement them without any delay.

(iv) **Secrecy :** It is easy to preserve secrecy in business. The important clues of business developed by the sole proprietor by his tact, foresight and skill can be kept as a closely guarded secret. In this form, there is also no need to disclose accounts or any other material fact to the public.

(v) **Personal Contact with Customers :** A sole proprietor can maintain intimate personal contact with his customers. Direct contacts will enable the proprietor to know the nature of his customer and their tastes, likes and dislikes. Close personal contact with the customers enhances the reputation of the firm.

(vi) **Direct Motivation:** In this form of business organisation, the proprietor takes all the profits and bears all the risks and losses. Thus, there is a direct relationship between effort and reward. This motivates the owner of the business to work hard to achieve maximum efficiency and effectiveness of the business.

(vii) **Independent Way of Life :** Sole proprietorship offers an independent way of life for people who have necessary skills, but do not wish to serve others. This provides an excellent opportunity of self-employment to persons of small means with personal skills.

(viii) Minimum Government Regulations : The proprietorship firm is subject to the minimum control of Government regulations. The sole proprietor has to comply with income tax, sales tax and labour laws. He is not subject to special legislations as in case of companies and partnership firms. There is no need of registration or filling of returns. Moreover, dissolution of the firm is also very easy.

3.2.3 Disadvantages of Sole Proprietorship :

(i) Limited Capital : The financial resources which a sole trader can raise are limited. He can depend on his personal resources and his borrowing capacity. The borrowing capacity depends on his assets and credit-worthiness. The limitation of financial resources may put hurdles in the expansion of the business.

(ii) Limited Managerial skills : All the managerial functions which are essential for the successful operation of a business are performed by the sole proprietor. Thus benefits of specialisation are not available. Moreover, the individual may not be able to perform all the managerial functions effectively because of limitations of time, skills, and imagination. Because of limited scale of operations and financial resources, it may not be feasible to secure the services of experts in various fields like production, purchasing and marketing.

(iii) Unlimited Liability : The liability of the sole proprietor is unlimited in the sense that the business creditors can even recover their debts from the personal assets of the proprietor. The proprietor may be completely ruined in case of failure of his business. This factor puts a ceiling on the growth and expansion of his business.

(iv) Uncertainty : There is wide uncertainty about the continuity of the business because the sole trader operates on a small scale and his activities are less diversified. The owner may be compelled to close his business in which he

concentrates. Moreover, death and insanity of the proprietor also lead to closure of business. In short, business sinks and swims with the proprietor.

(v) **Limited Opportunities** : Since the scale of operations is relatively small, the sole proprietor cannot avail the benefits of all business opportunities. Since there is one and the same person who provides capital and management, the sole proprietor may not be ready to take various risks which is essential for the growth of any business. Moreover, because of small scale operations, the trader is not able to reap the economies of large scale production, purchasing and marketing.

3.2.4 Survival of Sole Proprietorship

Despite its disadvantages, sole proprietorship form of organisation is very popular. According to W.R.Basset, "The one man control is the best in the world if that one man is big enough to manage everything". Sole tradership facilitates one man control which leads to various advantages like simplicity, ease of formation, flexibility, quick decision making and personal touch with customers. But it should also be remembered that one man control also has certain limitations particularly relating to finance and management. These limitations restrict the scale of business operations very small as compared to partnership firms and joint stock companies.

The sole proprietorship concern sinks and swims with its proprietor. The proprietor, who manages everything related to the business, may not have complete knowledge and skills which are required for the efficient performance of the business. His ill-health will also have an adverse effect on the working of the business. Thus, on many occasions, the business operations are beyond the capacity of one individual. He has to take the help of other people who can share business risks and contribute capital and managerial skills for running the enterprise.

The sole proprietorship form of organisation is highly suitable in the following cases:

- (a) Small business requiring modest capital and limited managerial talent as in case of retail stores.
- (b) In those lines of business where there is need for greater personal attention to customers as in tailoring, legal services, medical profession, etc.
- (c) In those lines of business where the demand of products is often influenced by seasonal trends and fashions.
- (d) In the production of unstandardised goods like embroidery or artistic things.
- (e) Where the individual has certain skills with the help of which he wants to earn his livelihood independently.
- (f) For catering to the demands of local market like perishable products, laundries, stores and confectioneries.

3.3 PARTNERSHIP FIRM

As a business enterprise expands beyond the capacity of a single person, a group of persons have to join hands together and supply the necessary capital and skills. Partnership firm thus grew out of the limitations of one man business. Need to arrange more capital, provide better skills and availability of specialisation led to the growth to partnership form of organisation.

According to Section 4 of the Partnership Act, 1932 partnership is "the relation between persons who have agreed to share the profits of a business carried on by all or anyone of them acting for all". In other words, a partnership is an agreement among two or more person to carry on jointly a lawful business and to share the profits arising therefrom. Persons who enter into such agreement are known individually as 'partners' and collectively as 'firm'.

3.3.1 Characteristics of Partnership

1. Association of two or more persons-maximum 10 in banking business and 20 in non banking business
2. Contractual relationship-written or oral agreement among the partners.
3. Existence of a lawful business
4. Sharing of profits and losses
5. Mutual agency among partners
6. No separate legal entity of the firm
7. Unlimited liability
8. Restriction on transfer of interest
9. Utmost good faith.

3.3.2 Formation of Partnership

A partnership firm can be formed through an agreement among two or more persons. The agreement may be oral or in writing. But it is desirable that all terms and conditions of partnership are put in writing so as to avoid any misunderstanding and disputes among the partners. Such a written agreement among partners should be properly stamped. It can be altered with the mutual consent of all the partners.

A partnership deed usually contains the following details:

- (1) Name of the firm.
- (2) Names and address of all the partners.
- (3) Nature of the firm's business.
- (4) Date of the agreement.

- (5) Principal place of the firm's business.
- (6) Duration of partnership, if any.
- (7) Amount of capital contributed by each partner.
- (8) The proportion in which the profits and losses are to be shared.
- (9) Loans and advances by partners and interest payable on them.
- (10) Amount of withdrawal allowed to each partner and the rate of interest.
- (11) Amount of salary or commission payable to any partner.
- (12) The duties, powers and obligations of all the partners.
- (13) Maintenance of accounts and audit.
- (14) Mode of valuation of goodwill on admission, retirement or death of a partner.
- (15) Procedure for dissolution of the firm and settlement of accounts.
- (16) Arbitration for settlement of disputes among the partners.
- (17) Arrangements in case a partner becomes involvement.
- (18) Any other clause (s) which may be found necessary in particular kind of business.

3.3.3 Registration of Firms

The Partnership Act, 1932 provides for the registration of firms with the Registrar of Firms appointed by the Government. The registration of a partnership firms is not compulsory. But an unregistered firm suffers from certain disabilities. Therefore, registration of a partnership is desirable.

Procedure for Registration. A partnership firm can be registered at any time by filing a statement in the prescribed form. The form should be duly signed by all the partners. It should be sent to the Registrar of Firms alongwith the prescribed fee. The statement should contain the following particulars:

1. Name of the firm.
2. Principal place of its business.
3. Name of other places where the firm is carrying on business.
4. Names in full and permanent addresses of all the partners.
5. Date of commencement of the firm's business and the dates on which each partner joined the firm.
6. Duration of the firm, if any.
7. Nature of the firm's business.

On receipt of the statement and the fees, the Registrar makes an entry in the Register of Firms. The firm is considered to be registered when the entry is made. The Registrar issues a Certificate of Registration. Any change in the above particulars must be communicated to the Registrar of Firms within a reasonable period of time so that necessary alterations may be made in the Register of Firms. The register is open for inspection on payment of a nominal fee.

3.3.4 Dissolution of Firm

A distinction should be made between the 'dissolution of partnership' and 'dissolution of firm'. 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. 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.

Modes of Dissolution of Firms

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

- 1. Dissolution by Agreement :** A partnership firm may be dissolved with the mutual consent of all the partners 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. In such a case, the dissolution takes place with effect from the date mentioned in the notice. If no date is mentioned, the firm would be dissolved with effect from the date of receipt of the notice by other partners. When such a notice is given to other partners, it cannot be withdrawn without their consent.
- 3. Contingent Dissolution :** A firm may be dissolved on the happening of any of the following contingencies:
 - (a) On the expiry of the term, if it is for a fixed period.
 - (b) On the completion of the firm's venture.
 - (c) On the death of a partner.
 - (d) On the adjudication of a partner as insolvent.
- 4. Compulsory Dissolution :** A firm stands automatically dissolved in the following cases:
 - (a) When all partners or all but one partner are declared insolvent.
 - (b) When the business of the firm becomes unlawful due to the happening of an event.

5. Dissolution through Court : Court may order the dissolution of a firm in the following cases:

- (a) When a partner becomes of unsound mind.
- (b) When a partner becomes permanently incapable of performing his duties as a partner.
- (c) When a partner is guilty of misconduct which is likely to affect prejudicially (e.g. moral turpitude, misuse of money) the business of the firm.
- (d) When a partner wilfully and persistently commits breach of the partnership agreement.
- (e) When a partner unauthorisedly transfers the whole of his interest or share in the firm to a third person.

3.3.5 Settlement of Accounts on Dissolution

When a partnership firm is dissolved, its assets are disposed of and the proceeds therefrom are utilised in paying the creditors. If the amount realised by sale of assets is not sufficient to discharge the claims of the creditors in full, the deficiency can be recovered proportionately from the personal properties of the partners. If any partner becomes insolvent, the remaining solvent partners will bear the loss in their capital ratio. In case the assets of the firm are more than sufficient to meet the liabilities in full, then the surplus may be utilised to pay off the loans and capitals contributed by the partners.

Section 48 of the Partnership Act, 1932 lays down the following procedure for the settlement of accounts between partners after the dissolution of the firm:

1. Losses including deficiencies of capital should be made good (a) first out of profits, (b) then out of capital, and (c) if need be, out of personal contributions of partners in their profit-sharing ratio.
2. The assets of the firm including any sum contributed by partners to make up deficiencies of capital will be applied for settling the debts of the firm, in the following order, subject to any agreement to the contrary;
 - (a) First, paying off the debts of the firm due to third parties;
 - (b) Then in paying to any partner any advances or loans given by him in addition to or apart from his capital;
 - (c) If any surplus is available after discharging the above liabilities, the capital contributed by the partner may be returned, if possible, in full or otherwise proportionately;
 - (d) The surplus, if any, shall be divided among the partners in their profit-sharing ratio.

3.3.6 Advantages of Partnership

- (i) **Ease of Formation :** Formation of a partnership is a simple process. An agreement which may be oral or written, is sufficient to enter into partnership. Registration of the firm is not compulsory. But if a firm wants to get itself registered, the procedure is very simple as compared to a joint stock company.
- (ii) **Flexibility :** The firm can undertake any kind of business agreed upon by all the partners. Moreover, there are not much restrictions under the Partnership Act on the manner and mode of management of the firm's operations. Capital, profit sharing ratio, pricing policy and other terms and conditions of the partnership can be changed easily.

(iii) **Matching of ownership and Control :** The partners who are the proprietors of the firm can also participate in the management of business. Moreover, there is a relationship between the efforts and rewards as in case of a sole trader. This acts as a motivating factor for the partners to work hard for the success of the business.

(iv) **Impact of Unlimited Liability :** The partners are severally and jointly liable for the debts of the firm upto an unlimited extent. This compels them to conduct business carefully by acting as a brake on hasty and reckless decisions. Each partner tends to be cautious and adopts sound business practices in the interest of the partnership business.

(v) **Secrecy :** Important secrets of a partnership firm can be maintained as it is not compulsory for it to get its accounts audited and published.

3.3.7 Disadvantages of Partnership

(i) **Limited Capital :** A partnership firm may not be able to raise as much capital as a company can. So, it may not be able to expand its operations beyond a certain limit.

(ii) **Conflict between Partners :** All the partners can participate in the management of the business. But difference in their skills, capacity and foresightedness may make a 'mess' of the business of the firm.

(iii) **Unlimited Liability :** Unlimited liability of partners, jointly and severally, discourages formation of partnership because creditors can make any or all the partners liable and recover their dues even from the private property of the partners.

(iv) **Delay in Decision Making :** The consent of all the partners is required in order to take all policy decisions. It may lead to delay in taking decisions.

(v) **Risk of Implied Agency :** Due to agency relationship between the partners, the acts of a partner are binding on the firm as well as the other partners. A dishonest or incompetent partner may bring disaster for the other partners.

(vi) **Non-transferability of Interest :** A partner cannot transfer his interest in the firm to outsiders without the unanimous consent of all other partners. This discourages the people from investing in partnership firms.

(vii) **Low Public Confidence :** Partnership firms enjoy less public confidence because of lack of legal restrictions over their formation and its dissolution and because of non-publicity of their accounts.

(viii) **Disruption in Continuity :** The continuity in partnership is uncertain. Its business may come to an end on the death, bankruptcy or lunacy of any one of the partners.

3.3.8 Suitability : Despite its various disadvantages and limitations, partnership firm has not lost popularity because it is a simple and convenient form of proprietorship. This form of organisation is suitable where the size of the business is relatively small and the capital requirements are low. It is also suitable where the partners do not trade, but use their professional skills. That is why this form of organisation is the most popular among chartered accountants, lawyers, stock brokers, estate agents, solicitors and doctors.

3.4 JOINT HINDU FAMILY FIRM

The Joint Hindu Family firm is a form of business organisation in which the family possesses some inherited property and the 'Karta' the head of the family, manages its affairs. It comes into existence by the operation of Hindu Law and not out of contract between the members or co-parceners. If the persons who have co-parcenary

interest in the ancestral property carry on business, it is a case of Joint Hindu family firm. Thus, the Joint Hindu Family Business is a business by co-parceners of a Hindu undivided estate.

The Joint Hindu Family business is confined only to those persons who constitute the co-parcenary interest. Such interest belongs to three successive generations in the male line who can inherit an interest in the ancestral property immediately on their birth in the family. Following the Hindu Succession Act, 1956, a female relative of a deceased male co-parcener will have a share in the co-parcenary interest after the death of the co-parcener in question.

Three generations next to the holder in unbroken male line constitute a co-parcenary, and property inherited by a Hindu from his father, father's father and father's grandfather is regarded as 'ancestral'. A son, grandson and great grandson become joint owners of the property by virtue of their birth in the family. The property is managed and held by senior member or the father as the Head of the Family, technically known as 'Karta'. In Hindu Law, a family business is taken as a part and parcel of the inheritable property, and therefore, the family business becomes the subject-matter of co-parcenary interest. The rights and liabilities of co-parceners are determined by the general rules of the Hindu Law. It should be noted that joint family firm is created by the operation of law and does not arise out of contract between the co-parceners.

3.4.1 Features of Joint Hindu Family

- (i) Only male persons of the family can claim co-parcenary interest in a Joint Hindu family business firm.
- (ii) The membership of the family business is the result of status arising from birth in the family. There is no question of the members being discriminated in terms of minority and majority on the basis of age.

- (iii) The right to manage the business vests in Karta alone. He has the implied authority to obtain loans through mortgage, etc. for the purpose of the business. Other members have neither any right to manage the affairs of the business nor any right to take loans on mortgage of family assets for the purpose of business.
- (vi) The liability of all the members of the Joint Hindu Family, except that of the Karta, is limited to the value of their individual interest in the joint property. The liability of the Karta is unlimited and as such extends to all that he owns as his separate and private property.
- (v) The share of each member's interest in the family property and business keeps on fluctuating. The member's interest increases by death of any existing co-parcener and increases by birth of a new co-parcener..
- (vi) The existence of the Joint Hindu Family Business is not affected by the death or insolvency of a co-parcener or even that of the Karta.

3.5 CO-OPERATIVE ORGANISATION

According to the International Labour Office, a co-operative organisation is 'an association of persons, usually of limited means, who have voluntarily together to achieve a common economic end, through the formation of a democratically controlled business organisation, making equitable contributions to the capital required and accepting a fair share of risks and benefits of the undertaking'.

A co-operative organisation is a voluntary association of individuals, generally belonging to one homogeneous group, who associate together to promote their common interests. The objectives of a co-operative organisation are economic in character. It is generally formed and registered under the Co-operative Societies Act, 1912 by the individuals of moderate means to protect their economic interests.

This form of organisation can be applied to every conceivable form of economic life of the members of community. Today there are a large number of credit societies, retail stores, building societies, marketing societies and producers' societies which are formed and run on the basis of co-operation.

3.5.1 Characteristics of Co-operative Organisation

(i) Voluntary Association. A co-operative organisation is a voluntary association of individuals belonging to a homogeneous group. People join it voluntarily for betterment of their economic interest through collective efforts. They can become the members of the co-operative society on their own and can leave it whenever they feel like, by giving a notice to the society. However, a member cannot transfer his shares in the society to another person.

(ii) Open Membership. There is no limitation on the number of members of a co-operative society. Its membership is open to all persons having certain common interests.

(iii) Service Motive. A co-operative organisation is established primarily with a view to rendering service to its members in particular and to the society in general. This, however, does not mean that such an organisation will not work for profit. There are several co-operative organisations which are making reasonably good profits. What we reiterate here is the emphasis on service and not on profit.

(iv) Capital. The capital of the co-operative organisation is procured from its members in the form of share capital. However, the share capital constitutes only a limited source of business finance. The major part of finance is raised by the co-operative institutions by way of grants and assistance from the Government.

(v) Return on Capital. The return on capital subscribed by the members is in the form of a fixed rate of dividend which is a charge on the trading surplus of the organisation.

(vi) **Distribution of Surplus.** The entire trading surplus earned by a co-operative organisation after meeting its trading expenses and paying a fixed rate of dividend is not distributed among the members. Under the present law governing co-operative organisations, a sum of about 1/4 of its profits is to be transferred to general reserves.

(vii) **Separate Legal Entity.** Like a company, a co-operative organisation also enjoys a separate and independent entity distinct from that of its members. As such, it has a perpetual life and is not affected by the entry and exit of members. It can sue and be sued in its own name. It can own property and dispose it off in its own name, likewise it can enter into business contracts in its own name.

(viii) **State Regulation.** A co-operative organisation right from its inception upto its end is subject to detailed regulation under the Co-operative Societies Act, 1992 or other State Co-operative Societies Act. A co-operative organisation, in order to be registered with Registrar of Co-operative Societies, has to fulfil certain requirements.

In short, co-operative organisation are 'mutual help' organisations and have the features of voluntary association and democratic management. To preserve stability alongwith voluntary association, it has a separate entity which limits the liability of members. Its life is not affected by the life of the members. It continues to exist through the transferability (although restricted) of the shares.

3.5.2 Merits of Co-operatives

Different types of co-operatives have distinct merits to their credit. But there are some common merits which can be witnessed in all co-operatives. These are as follows:

(i) **Easy formation.** Being a voluntary association, it is easy to form as it does not require long and complicated legal preliminaries. Any 10 adult persons can

voluntarily form themselves into an association and get it registered with Registrar of Co-operative Societies.

(ii) Democratic Functioning. As observed earlier, the management of a co-operative is vested in a managing committee which is elected by the members of the co-operative on the basis of 'one-man-one vote'. As such, it does not matter whether a member holds one share or more than one share.

(iii) Limited Liability. Like the liability of the shareholders in a company form of organisation, the liability of the members in a co-operative organisation is also limited to their capital contribution. The effect of limited liability is mentioned in the bye-laws of the co-operative society which is checked by the Registrar at the time of registering the same.

(iv) Continuity. Like the company, the co-operative also enjoys a separate legal entity of its own independent of its members who own it. Hence the life of a co-operative organisation remains unaffected by the death, insolvency or conviction of a member.

(v) Mutual Benefit Association. Co-operatives are formed on the basis of voluntary association of persons to provide them with certain services at 'no profit, no loss' basis. The members form a society on the basis of mutual help. It promotes a feeling of co-operation and selflessness among members.

(vi) Internal Vitality. Co-operatives are not permitted to declare dividend for their members exceeding 10 per cent. The balance of the surplus earned in any year by the co-operative can be utilized for its growth, modernisation and development. Thus there is built-in advantage of ploughing back of profits for the better health and prosperity of the organisation.

(vii) State Assistance. Since co-operatives have been adopted by the Government as an instrument of economic policy, a number of grants, loans and financial assistance are offered to them to make them function efficiently.

(viii) **Social Service.** Co-operatives foster fellow feeling among members and impart moral and educative values in their every day life which are essential for better living.

(xi) **Reducing Inequalities.** The benefits and profits of co-operatives are enjoyed by those people who are relatively of moderate means. This helps in raising the economic status of the relatively poor people thereby reducing the disparity between the rich and poor.

3.5.3 Disadvantages or Demerits of Co-operatives

(i) **Limited Capital.** The amount of capital that a co-operative can muster is limited because of the membership remaining confined to a particular locality or region and also because of the principle of 'one man one vote' and the dividend restrictions.

(ii) **Many State Regulations.** Under the existing law the co-operatives are subjected to a variety of regulations from the co-operatives department of the State Government partly because the State offers a number of financial helps and partly because it is always anxious to see that the movement succeeds. All this has led to excessive state regulations in the day-to-day functioning of the co-operatives which, at times, amounts to interference.

(iii) **Inefficient Operations :** The guaranteed market for the co-operatives slackens the efforts of the management. Moreover, the management may not comprise of competent and efficient persons to deal with the business problems. These are likely to make the co-operative organisation inefficient.

(iv) **Misuse of Funds :** Ignorance of business principles and misuse of funds for personal ends may lead to recurring losses. This may put the survival of the co-operative society in danger. The co-operative credit society may advance loans to

the members without sufficient security and the loans may be converted into bad debts in future.

(v) **Lack of Motivation :** There is a built-in constraint that co-operative society cannot offer dividend beyond a certain fixed rate (i.e., 10 per cent). The members of the managing committee with whom rests the responsibility of managing the co-operative do not feel sufficiently motivated to do their best to see the co-operative a grand success.

3.5.4 Formation of Co-operatives

As stated earlier the registration of a co-operative enterprise is compulsory. In order to get a co-operative society registered, an application in the prescribed form must be submitted to the Registrar of Co-operative Societies of the State in which the society's registered office is to be situated. Any ten persons above the age of 18 years and having common interest may submit a joint application for being formed into a co-operative society. The application should contain the following information.

- (i) The name and address of the Society.
- (ii) The aims and objects for which the society is being registered.
- (iii) The names, addresses and liabilities of the members.
- (iv) Division of share capital.
- (v) Method of admission of new members.
- (vi) Two copies of the byelaws (Rules and regulations) of the society.

A co-operative may adopt model byelaws given in the Co-operative Societies Act instead of framing its own byelaws.

Once the application for registration alongwith the copies of byelaws is submitted, the Registrar of Co-operative Societies will carefully scrutinise them in order to ensure that they are in accordance with the provisions and spirit of the Co-operative Societies Act. When he is fully satisfied in this connection, he will enter the name of the society in his register and will issue a certificate of registration. After getting the certificate of incorporation, the society becomes a body corporate having a separate legal entity of its own, with perpetual succession and limited liability of its members.

3.5.6 Management of Co-operatives

The management of co-operative society lies in the hands of a managing committee. Members of managing committee are elected directly by the committee members at the annual general meeting of the society. The managing committee consists of a number of members who elect from among themselves the following office bearers:

1. President
2. Vice-President(s)
3. Secretary
4. Joint Secretary, if any, and
5. Treasurer

The general body of shareholders lays down the broad objectives and policies of the co-operative society. The managing committee determines detailed programmes and procedures of the society. The committee also gets progress reports from the office-bearers and it is accountable to the members in annual general meeting . The officer-bearers of the society in turn are accountable to the managing committee. The committee must manage the society in accordance with the provisions of the Co-operative Societies Act,1912. The co-operative society must furnish annual

reports and accounts to the Registrar of Co-operatives. It must also get its accounts audited every year.

3.5.7 Types of Co-operatives

The principles of co-operation have been adopted in many fields of economic and social activity. The main forms of business co-operatives are as follows:

1. Industrial Co-operatives: Such co-operative societies are formed by small artisans and craftsmen to secure the benefits of collective and large-scale production so that they may survive against the competition of organised large-scale producers. Such societies seek to increase production, provide production facilities (raw materials, tools, technical knowledge, etc.) to members and to provide opportunities for self-employment. They help to safeguard the interests of poor artisans. These Co-operatives are known as producers' co-operatives. They may be of four types:

(a) Manufacturing or workshop co-operatives : Such societies are engaged in the actual production of goods. The members are employees of the society and they are paid wages for the goods produced by them for the society. The society provides all facilities to the member-workers. There are a number of co-operative sugar and cotton-ginning factories in India.

(b) Industrial service co-operatives : . In such co-operatives, the producer members maintain their separate individual entity and they produce goods separately. The society helps them by supplying manufacturing services like raw materials, tools, equipments, technical know how, etc.

(c) Common facility workshop co-operatives : Such societies provide common production facilities to members. Steel tempering units, calendering plants, electroplating units, anodizing plants, etc., are examples of such societies. Non-members can also avail of their services by paying service charges. Large amount of capital and technical know how is required in such societies.

(d) Co-operative industrial estates : Such societies are formed by small industrialists to develop industrial estate for the benefit of members. The society purchases and develops a vast tract of land and provides industrial sheds to members on rental basis. The industrial estate offers water, power, drainage, common tool room, transport and other facilities.

2. Marketing Cooperatives: Such cooperatives are formed for selling manufactured or agricultural products. Therefore, marketing co-operatives may be classified into two categories.

(a) Agricultural Marketing Co-operatives : These societies are formed by farmers for selling their produce at remunerative prices. An agricultural marketing Co-operative thus provides the benefits of collective purchase and sale.

(b) Industrial Marketing Co-operatives : These societies are organised by small producers such as weavers, artisans, shoe-makers, milkmen, etc., for selling their manufactured products. The main object of such societies is to improve the bargaining capacity of producer members so as to secure better prices and to eliminate the middlemen. Such societies also provide quality control, grading and packing services.

3. Credit Co-operatives: Co-operative societies are set up to pool the savings of members and to make them available as loans to those members who need credit on favourable terms. They encourage the habit of thrift and saving among the members. Such societies are formed by agriculturists, artisans, industrial workers, salary earners, etc., to provide short-term financial accommodation to the members.

4. Co-operative Farming Societies: Also known as agricultural cooperatives, these are associations of small land owners who pool their fragmented or subdivided landholdings and do farming on a collective basis so as to secure the benefits of large scale and mechanised farming. These societies are of the following types:

(a) Collective Farming Society : In such a society all land belongs to the society and the members work as wage earners on the farms. The surplus of the society is distributed among members in proportion to their wages earned by them. Collective ownership and collective operation are the distinguishing features of such a society.

(b) Joint Farming Society : Each member is an independent owner of land. The members combine their land and cultivate it jointly. They receive a share in the society's surplus in proportion to their landholdings. A limited dividend is also paid on the capital. Individual ownership and joint cultivation are the distinctive features.

In addition to the district level and State level co-operative societies central apex co-operative institutions or federation of co-operatives have been established in India. National Co-operative Union of India, National Agricultural Co-operatives Marketing Federation, National Federation of Industrial Co-operatives, National Federation of Co-operative Sugar Factories, National Co-operative Dairy Federation, National Consumers' Co-operative Federation, Indian Farmers' Fertilizers Co-operatives, National Co-operative Land Development Banks Federation are some examples of such apex bodies of co-operatives at the national level.

3.6 SUMMARY

The important forms of business organizations include sole proprietorship, joint hindu family firm, partnership firm, joint stock company and cooperative organisation. The first three of these may be categorised as non-corporate and the remaining two as corporate forms of organisation. The essential distinction between these two categories is that a non-corporate form of business may be started without legal formalities while a corporate body can be launched and run only after fulfilling

the required legal formalities. Sole tradership facilitates one man control which leads to various advantages like simplicity, ease of formation, flexibility, quick decision making and personal touch with customers. But it should also be remembered that one man control also has certain limitations particularly relating to finance and management. These limitations restrict the scale of business operations very small as compared to partnership firms and joint stock companies.

A partnership firm can be formed through an agreement among two or more persons. The agreement may be oral or in writing. This form of organisation is suitable where the size of the business is relatively small and the capital requirements are low. It is also suitable where the partners do not trade, but use their professional skills. That is why this form of organisation is the most popular among chartered accountants, lawyers, stock brokers, estate agents, solicitors and doctors. The Joint Hindu Family Business is confined only to those persons who constitute the co-parcenary interests. The rights and liabilities of co-parceners are determined by the general rules of the Hindu Law. It should be noted that joint family firm is created by the operation of law and does not arise out of contract between the co-parceners.

A co-operative organisation is a voluntary association of individuals belonging to a homogeneous group. People join it voluntarily for betterment of their economic interest through collective efforts. They can become the members of the co-operative society on their own and can leave it whenever they feel like, by giving a notice to the society. However, a member cannot transfer his shares in the society to another person.

3.7 KEYWORDS

Cooperative organisation: Cooperation is a form of organisation wherein persons associate together voluntarily for the furtherance of their common economic interests. Cooperatives may undertake production not for earning profits, but for the benefit of their members. Similarly, consumers may join hands to establish direct contact with the manufacturers and to eliminate middlemen's profits and thereby to provide consumer goods cheaply to the members of the cooperative society.

Joint stock company: A company that trades for the benefit of all its members and divide its profits among members according to the size of their contributions to its capital. The general members do not take part in the day-to-day running of the companies' business. It may be distinguished from associations of traders who trade for their own account and form partnerships where each partner takes an active part in running the business. A joint stock company is invariably incorporated with the registrars of the companies.

Joint Hindu Family Business: A business organisation owned by the co-owners or co-partners of an estate belonging to a Hindu Family which jointly owns it and has not yet been partitioned is called a Joint Hindu Family Business. Such business exists under the Mitakshara law which governs Hindu succession in all parts of India, except West Bengal and Assam, where Dayabhaga system of inheritance is practised. Under the former system of inheritance, Joint Hindu family comprised of those who held coparcenary interest in it. Such interest belonged to three successive generations in the male line who could inherit an interest in the ancestral property right after the moment of their birth. After the passage of the Hindu Succession Act of 1956, a female relative of a deceased male co-partner will have a share in the coparcenary interest after the death of the co-partner in question. This privilege is open even to male relative of the deceased who can claim it through specified certain female relatives of the deceased.

Partnership: An arrangement whereby two or more people agree to carry on a business together and to share the profits. Also an organization formed to carry out the business of a partnership. A partnership is not a corporation: all contracts made by a partnership are made by the partners acting jointly and all partners are liable for all the debts of their business.

Partnership deed: Partnership is formed by an agreement which may be oral, written or implied by conduct of the partners. An agreement in writing duly stamped and registered between persons to enter into and form a partnership is called a 'partnership deed'.

Sole trader: Sole trader is a person who runs a sole proprietorship in the field of commerce local, national or international. He brings in his own capital and uses his own skill and labour and is entitled to all the profits of the business. He acts both as the owner and the risk-bearer of his business.

3.8 SELF ASSESSMENT QUESTIONS

1. Describe the various legal forms of business organisation. Give in brief relative merits and demerits of each. What are their respective feasibility areas?
2. What are different forms of business organisation? If you were to start business, which one of these forms would you prefer and why?
3. What are the merits of partnership form of organisation?
4. What is a co-operative enterprise? Discuss its merits and demerits as a form of business organisation.
5. "One man control is the best in the world if the man is big enough to control everything." Do you agree? Give reasons.
6. Discuss characteristics of Joint Hindu Family form of business organisation.

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Lesson : 4	
JOINT STOCK COMPANY	

STRUCTURE

- 4.0 Objectives
- 4.1 Introduction
- 4.2 Meaning and Features of a Company
 - 4.2.1 Salient Features of a Company
 - 4.2.2 Advantages of a Joint Stock Company
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 - 4.2.4 Distinction between Partnership and Company
- 4.3 Types of Companies
- 4.4 Suitability of a Company form of Organisation
- 4.5 Distinction between Private and Public Companies
- 4.6 Suitability of a Private Company.
- 4.7 Exemptions and Privileges of a Private Company.
- 4.8 Choice of Form of Organisation
- 4.9 Choice between Manager and Partner
- 4.10 Summary
- 4.11 Keywords
- 4.12 Self Assessment Questions
- 4.13 References/Suggested Readings

4.0 OBJECTIVES

After reading this lesson, you should be able to-

- (a) explain definition, characteristics, advantages and disadvantages of Joint-Stock Companies;
- (b) distinguish between partnership and company form of organisation;

- (c) discuss various types of companies;
- (d) bring out difference between public limited and private limited company;
and
- (e) describe the various factors to be considered while selecting a good form of business organisation.

4.1 INTRODUCTION

With the growing needs of modern business, collection of vast financial and managerial resources became necessary. Proprietorship and partnership forms of ownership failed to meet these needs due to their limitations, e.g., unlimited liability, lack of continuity, and limited resources. The company form of business organisation was evolved to overcome these limitations. Joint stock company has become the dominant form of ownership for large scale enterprises because it enables collection of vast financial and managerial resources with provision for limited liability and continuity of operations.

4.2 MEANING AND FEATURES OF A COMPANY

A joint stock company is an incorporated and voluntary association of individuals with a distinctive name, perpetual succession, limited liability and common seal, and usually having a joint capital divided into transferable shares of a fixed value. Chief Justice John Marshall of U.S.A. defined a company in the famous Dartmouth College case as "an artificial being, invisible, intangible and existing only in contemplation of law; being the mere creature of law it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence; and the most important of which are immortality and individually." Thus, a company is an artificial legal person having an independent legal entity.

4.2.1 Salient Features of a Company

The salient features of a company are as follows:

1. **Separate legal entity** : A company has an existence entirely distinct from and independent of its members. It can own property and enter into contracts in its own name. It can sue and be sued in its own name. There can be contracts and suits between a company and the individual members who compose it. The assets and liabilities of the company are not the assets and liabilities of the individual members and vice versa. No member can directly claim any ownership right in the assets of the company.
2. **Artificial legal person** : A company is an artificial person created by law and existing only in contemplation of law. It is intangible and invisible having no body and no soul. It is an artificial person because it does not come into existence through natural birth and it does not possess the physical attributes of a natural person. Like a natural person, it has rights and obligations in terms of law. But it cannot do those acts which only a natural person can do, e.g., taking an oath in person, enjoying married life, going to jail, practising profession, etc. A company is not a citizen and it enjoys no franchise or other fundamental rights.
3. **Perpetual succession** : A company enjoys continuous or uninterrupted existence and its life is not affected by the death, insolvency, lunacy, etc., of its members or directors. Members may come and go but the company survives so long as it is not wound up. Being a creature of law, a company can be dissolved only through the legal process of winding up. It is like a river which retains its identity though the parts composing it continuously change.
4. **Limited Liability** : Liability of the members of a limited company is limited to the value of the shares subscribed to or the amount of a guarantee given by them. Unlimited companies are an exception rather than the general rule. In a

limited company, members cannot be asked to pay anything more than what is due or unpaid on the shares held by them even if the assets of the company are insufficient to satisfy in full the claims of its creditors.

5. Common seal : A company being an artificial person cannot sign for itself. Therefore, the law provides for the use of common seal as a substitute for its signature. The common seal with the name of the company engraved on it serves as a token of the company's approval of documents. Any document bearing the common seal of the company and duly witnessed by at least two directors is legally binding on the company.

6. Transferability of shares : The shares of a public limited company are freely transferable. They can be purchased and sold through the stock exchanges. Every member is free to transfer his shares to anyone without the consent of other members.

7. Separation of ownership and management : The number of members in a public company is generally very large so that all of them or most of them cannot take active part in the day-to-day management of the company. Therefore, they elect their representatives, known as directors, to manage the company on their behalf. Representative control is thus an important feature of company.

8. Incorporated association of persons : A company is an incorporated or registered association of persons. One person cannot constitute a company under the law. In a public company, at least seven person and in a private company at least two person are required.

4.2.2 Advantages (Popularity) of Joint Stock Company

Joint stock company has gained popularity throughout the world as a form of business organisation. It is superior to a sole proprietorship concern and a partnership firm in the following respects:

(i) **Vast Financial Resources** : A company can raise huge financial resources. It can issue different types of securities (i.e. equity shares, preference shares, and debentures) to attract different types of investors. A company can also raise finance from the public in the form of public deposits and banks and other financial institutions.

(ii) **Continued Existence** : A joint stock company is a separate legal entity distinct from those who are its members or who promoted it. As an incorporated body, it enjoys perpetual existence. It continues to function so long it has the minimum number of the members required by law. Thus, it is a stable form of organisation and is best suited for a business which requires a long period to establish and consolidate.

(iii) **Limited Liability** : The liability of the shareholders of a joint stock company is limited to the face value of the shares held by them. Their private properties are not attachable to recover the debts of the company. Thus, this form of organisation is a great attraction to persons who do not want to take much risk.

(iv) **Scattered Risk** : Shares of a company can be held by a large number of people. Thus, the risk of loss spread over a large number of persons and the possibility of hardship on a few persons in case of partnership or of sole proprietorship is avoided in case of failure of business.

(v) **Transferability of Shares** : The shareholders of public companies are entitled to transfer the shares held by them to others. The shares of most companies are listed on the stock exchange and hence can be readily sold. This ensures liquidity of investments and encourages investment of funds in the companies.

(vi) **Economies** : A company is in a position to raise huge capital and can undertake large scale operations. The increase in the size of the business operations would result in the economies in production, purchase, selling, management, etc. Thus, cost of production will be less and higher efficiency will be achieved as compared to other forms of business organisation.

(vii) Expert Management : Since a company carries business on a large scale and has huge financial resources, it can afford the services of expert personnel. This will lead towards professionalisation of management which is necessary for the efficient management of any business.

4.2.3 Disadvantages of Joint Stock Company

Company form of business organisation suffers from the following limitations:

(i) Difficult Formation : In order to form a company, a large number of legal formalities have to be complied with. A number of documents have to be drafted and filed with the Registrar of Companies. This requires large amount of expenses to pay for the services of the experts, printing and stationery charges, registration fee, and other office and administrative expenses. A public limited company has to go through additional legal formalities to raise capital and to get certificate of commencement of business.

(ii) Government Control : A company has to follow many provisions of different Acts. Even the internal working of the company is subjected to statutory restrictions regarding meetings, voting, audit, etc. The existence of so many legal restrictions in running the business might discourage the people to start new companies.

(iii) Economic Oligarchy : The management of a company is supposed to be conducted as per the desires of the shareholders. But they have practically no say in the affairs of the company. Very often directors tend to mislead the shareholders by their 'window dressed' reports. This makes control of shareholders illusory. They also create group among the shareholders and thus consolidate their hold on the company by manipulations of voting power. Thus, separation of ownership and management results in oligarchie management and it makes control of shareholders illusory.

(iv) Fraudulent Practices : The fraudulent promoters may misuse the capital raised from the public for their personal ends. This creates panic among the public. The directors of the company may also manipulate the prices of the stocks in the stock exchange by manipulating the books of accounts of the company.

(v) Delayed Decision-making : The process of decision-making in a company is slow as compared to a sole trader or partnership firm. All the important decisions are to be taken either by the Board of Directors or by the shareholders. Calling the meetings of the Board or the shareholders consumes a long time. Thus, crucial decisions are delayed in the process.

(vi) Difficulty in Winding Up : It is very difficult to wind up a company. A very long and cumbersome procedure had to be followed to wind up the affairs of the company.

4.2.4 Distinction Between Partnership and Company

	Basis	Partnership	Company
1.	Regulating Act	Indian Partnership Act, 1932	Companies Act, 1956
2.	Number of members	Minimum-2, Maximum 20 in ordinary business and 10 in banking business	<i>Private Company</i> – Minimum-2, Maximum-50. <i>Public Company</i> – Minimum-7, maximum- authorised capital
	divided into		the number of shares.
3.	Entity	No separate legal entity from that of its partners.	Separate legal entity from that of its members.
4.	Liability	Unlimited	Limited
5.	Management	All partners are entitled to participate	Only members of the Board of Director are entitled to manage.

6.	Transfer of interest	Not possible without the consent of all the partners.	Freely transferable except in case of private companies.
7.	Formation	No legal formalities. If may or may	Only after fulfilling legal not be registered
		formalities. Incorporation is a	must.
8.	Regulation of working	No statutory regulation in day-to-day working.	Has to comply with various statutory requirements and submit numerous return to the Government.
9.	Stability	Unstable life - comes to an end with the retirement, death or insanity of a partner.	Prepetual life unaffected by the death, separation, insolvency, etc. of the shareholders.
10.	Audit of accounts	Not obligatory	Legally compulsory
11.	Financial resources	Limited	Vast
12.	Winding up	Can be dissolved at will without any legal formalities.	Cannot be wound up at will. Winding up regulated as per provisions of the Companies Act.

4.3 TYPES OF COMPANIES

The companies may be classified on the basis of mode of incorporation, public interest, company to company relationship and nationality as shown in Fig. 4.1

Statutory Company : Such a company is incorporated through a special Act of the State Legislature or Parliament. They are governed by the provisions of the Acts creating them and the provisions of the Companies Act do not apply to them. Such companies need to have a Memorandum of Association and also need not use the word 'Limited' in their names. The examples of such companies are Reserve Bank of India, Industrial Development Bank of India, Life Insurance Corporation and State Trading Corporation.

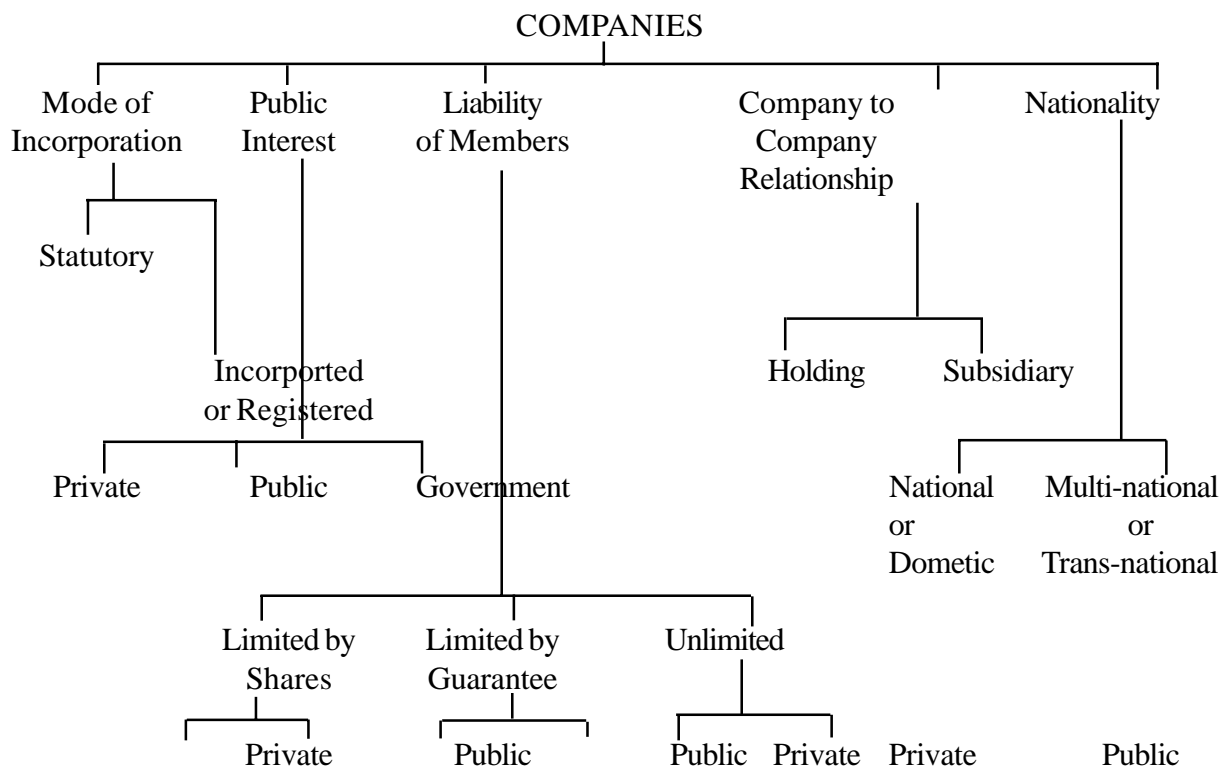


Fig. 4.1 Classification of Companies

Private Company : A private company means a company which by its articles :

- (a) restrict the right to transfer its shares, if any;
- (b) Limit the number of its members to 50; and
- (c) prohibit invitation to the public to subscribe for any shares or debentures of the company.

While counting the number of members of a private company, the following are not included :(i) persons who are in employment of the company; and (ii) persons who having been formerly in employment of the company, were members of the company while in that employment and have continued to be members after the employment ceases; and where two or more persons hold one or more shares in a company jointly, they shall be treated as a single member for the purpose of above definition.

There must be at least two persons to form a private company. The maximum limit on the number of its members is fifty. Its shares are non-transferable and it prohibits any invitation to the public to purchase its shares and debentures.

Public Company : A company which does not fulfil the qualifications of a private company is known as a public company. Thus, a public company is one which (a) does not put any restriction on the transfer of its shares, (b) does not limit the number of its members to fifty, and (c) invites the general public to subscribe to its shares and debentures. Thus, membership of a public company is open to the general public and there is no maximum limit to the number of its members.

Government Company : A Government company is one whose entire or not less than 51% of its paid-up share capital is held by the Central Government, or a State Government or jointly by the Central and State Governments, and includes a company which is a subsidiary of a Government company.

A government company may be either a public company or a private company. In India, most of the government companies have entire paid up share capital held by the Central Government, and /or the State Government(s). Examples of government companies are: Bharat Heavy Electricals Ltd., Hindustan Machine Tools Ltd., Fertiliser Corporation of India and National Industrial Development Corporation.

Companies Limited by Shares : Where the liability of the members of a company is limited by the memorandum to the amount unpaid on the shares, such a company is known as 'a company limited by shares' or a limited liability company (Sec. 12(2)(a)). The liability can be enforced any time during the winding-up of the company. It means if the shares are fully paid, the liability of the shareholder holding such shares is nil. The essential feature of this company is that it must have a share capital, as the extent of liability is determined by the face value of the share. These are not most popular types of organisation.

Companies Limited by Guarantee : A company limited by guarantee may be defined as 'a company having the liability of its members limited by its memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the even of its being wound up' (Sec. 12(2)(b)). The amount guaranteed by each member can not be demanded until the company is wound up. Here it is in the nature of a 'reserve capital'.

Such companies are formed not for the purpose of profit but for the promotion of art, science, culture, charity, sport, commerce or some similar purpose. The chamber of commerce, trade associations and sport clubs are usually guarantee companies because they neither require a huge, capital or aim at making profits.

Unlimited Companies : A company having no limit on the liability of its members is an unlimited company (Sec. 12(2)(c)). It means the liability of members of this type of company is unlimited, i.e. it may extend to the personal property of the members.

Every member is liable for the debts of the company, as an ordinary partnership, in proportion to his interest in the company. Such a company may or may not have a share capital. If it has a share capital, it may be a public company or a private company.

Holding Company and Subsidiary Company (Sec.4) : When a company has control over another company, it is known as the holding company and the company over which control is exercised is called the subsidiary company. The Act defines these terms as under :

Holding Company : "A company shall be deemed to be the holding company of another, if that other is its subsidiary (Sec. 4(4)).

Subsidiary Company (Sec. 4(1) : A company is deemed to be under the control of another (i.e. a subsidiary company), if and only if –

- (a) that other controls the composition of board of directors;
- (b) that other company holds more than half of nominal value of its equity share capital, or
- (c) it is a subsidiary of any other company which is the other company's subsidiary.
- (d) that other company controls more than half of the total voting power of the other company.

Multi-national or Trans-national Companies : Such companies extend the areas of their operations beyond the country in which they are registered. For instance, Coca Cola is a company registered in the U.S.A and it has production and marketing facilities in many countries of the world. Some other popular multi-national corporations include Pepsi (USA), Ponds (USA), Brook Bond (U.K) Sony (Japan), and Suzuki (Japan).

4.4 SUITABILITY

Despite its drawbacks, the company form of organisation has become very popular, particularly for large business concerns. This is because its merits far outweigh the demerits. Many of the drawbacks of a company are mainly due to the weaknesses of the people who promote and manage companies and not because of the company system as such. The company organisation has made it possible to accumulate large amounts of capital required for large scale operations. Due to its unique characteristics, the company form of ownership is ideally suited to the following types of business:

- (a) heavy or basic industries like ship-building, coach-making factory, engineering firms, etc., requiring huge investment of capital.
- (b) large scale operations are very crucial because of economies of scale, e.g., departmental stores, chain stores and enterprises engaged in the construction of bridges, dams, multistoreyed buildings, etc.

- (c) the line of business involves great uncertainty or heavy risk, e.g., shipping and airline concerns.

4.5 DIFFERENCE BETWEEN PUBLIC COMPANY AND PRIVATE COMPANY IS SHOWN BY TABLE 4.2

Table 4.2 distinction between Private and Public Companies

<i>Point of Distinction</i>	<i>Private Company</i>	<i>Public Company</i>
1. Number of Members	Minimum -2 Maximum-50	Minimum-7 Maximum-No limit
2. Name	The name must include the word "Private Limited"	The name must include the word "Limited".
3. Number of directors	Minimum-2	Minimum-3
4. Articles of Association	Must prepare its own Articles of Association.	May adopt Table A as given in the Companies Act.
5. Public Subscription	Cannot invite public to subscribe to its shares and debentures	Generally invites public to subscribe to its shares and debentures.
6. Prospectus	Need not issue and file a prospectus	Must issue and file a prospectus or a statement in lieu of prospectus.
7. Allotment of Shares	No restrictions on allotment of shares. No binding on further issue of shares	Cannot allot shares without raising minimum subscription and without complying with other legal formalities. Further issue of shares must in the first instance be offered to the exiting members.
8. Commencement of Business	Can commence its business immediately after getting the Certificate of Incorporation	Can commence business only after getting the Certificate of Commencement of Business.
9. Transfer of shares	Restriction on transfer of shares	No restriction on transfer of shares.
10. Share Warrants	Cannot issue share warrants.	Can issue share warrant per bearer.

11. Statutory Meeting and Report	Not required to hold statutory meeting or file a statutory report.	Must hold a statutory meeting and file a statutory report.
12. Deferred shares	Can issue deferred shares with disproportionate voting rights.	Cannot issue such shares.
13. Directors	<p>(a) No qualification shares</p> <p>(b) Directors need not retire by rotation every year.</p> <p>(c) No restriction on the appointment and reappointment of managing/whole time directors.</p> <p>(d) No limit on number of directorship.</p> <p>(e) A director can occupy any office of profit.</p> <p>(f) Interested director can vote in the board meeting.</p>	<p>(a) Qualification shares prescribed.</p> <p>(b) One third of the two third of directors must retire by rotation every year.</p> <p>(c) Appointment and reappointment require approval of the Central Government.</p> <p>(d) An individual cannot be a director of more than 20 companies.</p> <p>(e) Special resolution required for this purpose.</p> <p>(f) Interested director can not vote in the meeting.</p>
14. Managerial Remuneration	No restrictions on directors remuneration	Total annual remuneration must not exceed 11 per cent of the net profit. In case of insufficiency of profits, the maximum limit is Rs. 50,000 per annum.
15. Index of Members	Need not keep a separate index of members	If membership exceed 50, a separate index of members is required.

4.6 SUITABILITY OF PRIVATE COMPANY

The above description reveals that a private company is a compromise between partnership and public company. To some extent, it combines the advantages of both. It enjoys the advantages of separate legal entity, continuity, limited liability and business secrecy. At the same time, it is free from excessive government regulation and progressive income-tax liability.

For these reasons, a private company is very suitable for organising a medium-sized business involving considerable risk of loss or uncertainty of profit. Wholesale trade, large scale retailing, e.g., departmental stores, chain stores, etc., and transportation services are examples of such business. Private company is also preferred by those who wish to take the advantage of limited liability but at the same time desire to keep control over the business within a limited circle of friends and relatives and want to maintain the privacy of their business. A family can maintain secrecy of business, avoid the risk of unlimited liability and avail of the facility or ease of partnership. Due to the small number of members there can be high degree of privacy and there is comparative freedom from legal requirements. Private company organisation is also appropriate in case of business of speculative nature, e.g., hire-purchase trading, stock-brokers, underwriting firms, etc. Another reason for the popularity of private company organisation is several exemptions and privileges granted by law.

4.7 EXEMPTIONS AND PRIVILEGES OF A PRIVATE COMPANY

The exemptions and privileges of private companies may be discussed under two categories, namely (1) exemptions and privileges available to all private companies, and (2) exemptions and privileges available to independent private companies.

Exemptions and privileges available to every private company (including the subsidiary of a public company) are as follows :

- (i) Only two persons (as against seven in case of a public company) are required to form a private company.
- (ii) A private company may have only two directors whereas a public company is required to have at least three directors.
- (iii) It is not required to prepare and file prospectus or statement in lieu of prospectus with the registrar of the companies.

- (iv) A private company can proceed with the allotment of shares without having raised minimum subscription by way of application money. A public company cannot do so.
- (v) It is not required to publish and register particulars of allotment of shares.
- (vi) It can commence business immediately after receiving the certificate of incorporation and it is not necessary to obtain the certificate of commencement of business.
- (vii) A private company is not required to convene a statutory meeting and file a statutory report. A public company must hold a statutory meeting after one month and before 6 months from the date mentioned in the certificate of commencement of business in order to acquaint the shareholders about the progress of the company's working till that date.
- (viii) It is not required to offer further issues of shares to the existing shareholders on a pro-rata basis, i.e., in proportion to their present shareholdings in the first instance. A public company is under legal obligation to do so.
- (ix) In a private company, the quorum required for the general meeting of shareholders is two persons personally present unless a higher number is provided in the articles of association. But for a public company the quorum is five persons personally present.

The above factors may be considered as the advantages enjoyed by a private company over a public company.

Exemptions and privileges available to an independent private company (not being subsidiary of a public company nor being deemed to be a public company) are given below:

- (i) It can provide financial assistance for the purchase of or subscription to its own shares.

- (ii) It is permitted to grant loans to and invest in the shares and debentures of other companies under the same management. Such loans and investments are known as inter-company loans and inter-company investments, respectively.
- (iii) It can issue deferred shares with disproportionate voting rights.
- (iv) Such a company can grant loans to its directors without the approval of the Government.
- (v) It is not required to keep a copy of its profit and loss account and balance sheet open for inspection by a non-member, thus, it can keep its affairs secret.
- (vi) It is free from the provisions as to general meetings, e.g., service of notice, election of Chairman, proxies, voting and polls. It can frame its own rules and regulations in this regard in its articles of association.
- (vi) In such a company, a director can attend the meeting of Board of Directors and can exercise his vote on a matter in which he has an interest.
- (viii) It can appoint any person holding an office or place of profit as director without passing a special resolution.
- (ix) Such a private company can refuse to register a transfer or transmission of its shares and there is no right of appeal to the Central Government against such refusal.
- (x) It is free from the restriction relating to the appointment, reappointment, tenure of office and remuneration of managerial personnel. A person can be a director or managing director in any number of such companies. All the directors can be appointed by a single resolution. All directors of such a company can be permanent and need not to retire by rotation. There is no limit on the remuneration of directors, managing director and manager in such a company. Approval of the Central Government is not required for the appointment, reappointment and for increase in the number and remuneration of such personnel.

4.8 CHOICE OF FORM OF ORGANISATION

As explained earlier, a business enterprise can be organised into several forms. Every form of organisation has its own merits and demerits. A businessman has to keep in view these merits and demerits while selecting an appropriate form of organisation. The choice has to be made both at the time of setting up a new enterprise and at the time of expansion and growth of an existing concern.

At the time of launching a new business enterprise, the choice of the form of ownership is dictated by several factors as given below:

1. Nature of business – Service, trade, manufacturing.
2. Scale of operations – Volume of business (large, medium, small) and size of the market area (local, national, international) served.
3. Degree of capital control desired by owners.
4. Amount of capital required initially and for expansion.
5. Degree of risk and liability and the willingness of owners to assume personal liability for debts of business.
6. Division of profits among the owners.
7. Length of life desired by the business.
8. Relative freedom from government regulations.
9. Scope and plan of internal organisation.
10. Comparative tax liability.

It must be noted that these factors are interrelated and interdependent. For instance, the amount of capital required and the degree of risk involved depend upon the nature and volume of business operations. The degree of control and the division

of profits are both related to risk and liability. Therefore, an entrepreneur should not consider these factors in isolation. The interrelationship between these factors should be duly considered. The impact of each one of these factors on the choice of a suitable form of ownership is described as follows:

1. Nature of business: The nature of business has an important bearing on the choice of the form of ownership. Business providing direct services, e.g., small retailers, hair-dressing saloons, tailors, restaurants, etc., and professional services, e.g., doctors, lawyers, etc., depend for their success upon personal attention to customers and the personal knowledge or skill of the owner and are, therefore, generally organised as proprietary concerns. Business activities requiring pooling of skills and funds, e.g., wholesale trade, accounting firms, tax consultants, stock brokers, etc., are better organised as partnership. Manufacturing organisations of large size are more commonly set up as private and public companies.

2. Size and area of operations: Large scale enterprises catering to national and international markets can be organised more successfully as private or public companies. The reason is that large-sized enterprises require large financial and managerial resources which are beyond the capacity of a single person or a few partners. On the other hand, small and medium scale firms are generally set up as partnership and proprietorship. Small scale enterprises like hair-dressers, bakeries, laundries, workshops, etc., cater to a limited market and require small capital. The risk and liability are not heavy and the management problems can be handled by the owner himself. Therefore, the owner likes to be his own master by organising as a sole proprietor. He can maintain face-to-face relationship with his customers which is important in small service enterprises like painter, decorators, repair shops, beauty parlours, etc. Medium-size enterprises and professional firms, e.g., health clinic, chartered accountants etc., are predominantly partnerships. They pool their capital and expertise to operate on a large scale and to avail of the benefits of

specialisation. Large scale enterprises and enterprises involving heavy risk, e.g., engineering firms, departmental stores, five star hotels, chain stores, etc., are normally organised as companies. These enterprises require huge capital and are normally organised as companies. Similarly, where the area of operations is widespread (national or international), company ownership is appropriate. But if the area of operations is confined to particular locality, sole proprietorship or partnership will be a more suitable choice.

3. Degree of control desired : A person who desires direct control of business prefers proprietorship rather than the company because there is a separation of ownership and management in the latter case. In case the owner is not interested in direct personal control but in large scale operations, it would be desirable to adopt the company form of ownership.

4. Amount of capital required : The funds required for the establishment and operation of a business have an important impact on the choice. Enterprises requiring heavy investment, i.e., iron and steel plants, etc., should be organised as joint stock companies. A partnership has to convert into a company when it grows beyond the capacity and resources of few persons. Requirements of growth and expansion should also be considered in making the choice. There is maximum scope for expansion in case of a public company. Where the funds required initially are small and scope for expansion is not desired, proprietorship or partnership is a better choice.

5. Degree of risk and liability : The volume of risk and the willingness of owners to bear it, is an important consideration. A single individual may have large financial resources sufficient for a medium scale enterprise but due to unlimited personal liability he may not like to organise as proprietor or a partnership. Due to limited liability and a large number of shareholders, there is maximum diffusion of risk in a public company. But an enterprising individual not afraid of unlimited liability may go in for sole proprietorship.

6. Division of surplus : A sole trader receives all the profits of his business but he also bears all the risks. If a person is ready to bear unlimited personal liability and desires maximum share of profits, proprietorship and partnership are preferable to company form of organisation.

7. Duration of business: Temporary and adhoc ventures can be organised as proprietorship as they are easy to form and dissolve. Enterprises of a permanent nature can be better organised as joint stock companies and co-operatives because they enjoy perpetual succession. A business requiring a long period for establishment and constitution should be organised as a corporate body.

8. Government regulation and control: Proprietorship and partnership are subject to little regulation and control by the Government. Companies and co-operatives are , on the other hand, subject to several restrictions and have to undergo several legal formalities. But this factor is not very important and it can be helpful in making the choice only when all other factors are unable to indicate a clear-cut choice.

9. Managerial requirements : Organisational and administrative requirements depend upon the size and nature of business. Small businesses using simple processes of production and distribution can be managed effectively as proprietorship and partnerships. On the other hand, giant enterprises involving the use of complex techniques and procedures require professional management. Such enterprises can be managed efficiently only as joint stock companies. Due to identity of ownership and management, motivation is very high in proprietorship and partnerships. Such motivation is lacking in a company due to separation of ownership from management.

10. Flexibility of operations: Businesses which require a high degree of administrative flexibility should better be organised as proprietorships or partnerships. Flexibility of operations is linked with the internal organisation of a business. The internal organisation of sole proprietorship and partnership is much

simple and less elaborate than the internal organisation of joint stock company. Moreover, the objectives of a company cannot be changed easily or without legal formalities.

11. Tax burden: Various forms of ownership are taxed differently under the Income-tax Act in India. If the expected volume of profit is very high it may be profitable to start a company. A company is taxed at a uniform rate, i.e., the rate of tax remains the same irrespective of the volume of profits, whereas in case of partnership and proprietorship the rate of tax increases with the volume of taxable income.

The above analysis indicates the basic consideration in the choice of a form of ownership is the nature and size of business. All other factors are dependent on this basic consideration. The scope and plan of organisation will also vary with the size and nature of business. In a grocery store, for example, the organisation will be simple as few employees will be needed. Thus, the nature and size of business is the key factor in the choice of a form of ownership.

4.9 CHOICE BETWEEN MANAGER AND PARTNER

A sole proprietor who is willing to expand his business may either appoint a salaried manager or assistant or may take one or more partners. He should analyse the merits and demerits of these alternatives in the light of the following factors:

(i) **Reorganisation :** If a manager is appointed, there is no change in the form of ownership organisation. Only a contract of service is to be entered into with the manager. But if a partner is to be taken, a partnership agreement must be entered into and a partnership deed must be drafted to lay down the terms and conditions of the partnership agreement. In addition, finding a suitable person who may be taken as a partner is a very difficult job. But it is relatively easier to appoint a manager.

(ii) **Capital :** A manager is an employee of the proprietor and he is not bothered with the procurement of capital for the business. The proprietor has to raise funds from his own resources or from his friends and relatives for the purpose of investment in the business. But if he takes a partner, the new partner will bring in additional capital.

(iii) **Control and Management :** When a manager is appointed, the ultimate control remains with sole proprietor. But if he takes a partner, he will have to share the control of the business with him unless the partner is a sleeping partner who contributes capital but does not take part in management. Since a manager is a paid employee and is concerned with the security of his job, he will show greater interest in his job. But a partner may not take full interest in the partnership business or may not have the required knowledge and skill. In order to secure greater interest of the partners, they are generally paid salary and a commission on the profit of the firm.

(iv) **Risk :** When a manager is employed , the proprietor bears all the risks of the business himself. But in case of a partnership firm, risks are shared by all the partners. Every partner is jointly and severally liable for the acts of other partners and for the entire debts of the firm.

(v) **Secrecy :** The proprietor can keep all the important business secrets with himself by appointing a manager. He is expected to disclose the business secrets in case he takes one or more partners. These secrets will remain safe so long as partners act in good faith and have good relations among them.

(vi) **Continuity :** A sole proprietorship business comes to an end with the death, insolvency or insanity of the proprietor. But a partnership firm can be carried on by the remaining partners in case of death, insolvency or insanity of a partner. Moreover, the chances of survival and growth of a partnership firm are higher because it has more funds and greater capacity to undertake business risks.

(vii) State Regulation : Employment of a manager involves no compliance with any legal regulation. In case of a partnership also, the amount of State regulation is minimum. But in case of partnership, the share of profit payable to the partners is liable to tax in the hands of the firm if the firm is not registered under the Income Tax Act.

From the above discussion, it can be concluded that a sole proprietor will find it better to appoint a manager rather than take a partner, if he wants to share the risks and profits and expand his business which is beyond his capacity, he will have to join hands with one or more partners.

4.10 SUMMARY

The joint stock company is gaining popularity throughout the world as a form of business organisation because it is superior to a sole tradership concern and a partnership firm in many respects which have already been explained in the chapter. A joint stock company has a perpetual existence, and its members have limited liability. If it is a public company, it can raise vast financial resources and can spread the business risk over a large number of people. It can employ professional managers and the latest techniques of production. A public company is more suitable for a large-scale business. It is also beneficial from the society's point of view. It mobilises the scattered savings of the public and invest them in industrial and commercial ventures. It also helps in the better utilisation of national resources.

The Joint Stock company form of organisation is not always suitable for the business. Sole proprietorship and partnership are more suitable where the scale of operation is small and customers require greater personal attention. They are also more suitable in those lines of business where the demand of products is often influenced by seasonal trends and fashion. The basic reasons for the survival of sole proprietorship and partnership are ease of their formation, maintenance of business

secrecy and less government central. Cooperative organisation satisfies the needs of those individuals who want to serve the society. 'No profit no loss' is the motto of co-operative organisations. They are formed to protect the interests of a class of people like consumers, agriculturists and producers.

4.11 KEYWORDS

Company: Section 3(1) (i) and (ii) of the Companies Act define a company as "a company formed and registered under this Act or an existing company means a company formed and registered under any of the former Companies Acts". At the time of application for registration, the sponsors must submit the Articles and Memorandum of Association.

Government Company : A Government company is one whose entire or not less than 51% of its paid-up share capital is held by the Central Government , or a State Government or jointly by the Central and State Governments, and includes a company which is a subsidiary of a Government company. A government company may be either a public company or a private company.

Holding Company and Subsidiary Company (Sec.4) : When a company has control over another company, it is known as the holding company and the company over which control is exercised is called the subsidiary company. The Act defines these terms as under :

Multi-national or Trans-national Companies : Such companies extend the areas of their operations beyond the country in which they are registered.

Private Company : A private company means a company which by its articles :

- (a) restrict the right to transfer its shares, if any;
- (b) Limit the number of its members to 50; and
- (c) prohibit invitation to the public to subscribe for any shares or debentures of the company.

Public Company : A company which does not fulfil the qualifications of a private company is known as a public company. Thus, a public company is one which (a) does not put any restriction on the transfer of its shares, (b) does not limit the number of its members to fifty, and (c) invites the general public to subscribe to its shares and debentures. Thus, membership of a public company is open to the general public and there is no maximum limit to the number of its members.

Statutory Company : A company that incorporated through a special Act of the State Legislature or Parliament. They are governed by the provisions of the Acts creating them and the provisions of the Companies Act do not apply to them. Such companies need to have a Memorandum of Association and also need not use the word 'Limited' in their names.

Unlimited Companies : A company having no limit on the liability of its members is an unlimited company (Sec. 12(2)(c)). It means the liability of members of this type of company is unlimited, i.e. it may extend to the personal property of the members.

4.12 SELF ASSESSMENT QUESTIONS

1. Explain the factors which you would bear in mind while selecting a form of business organisation.
2. "Corporate form of business is superior to proprietary and partnership forms." Discuss this statement and analyse the financial reasoning behind the adoption of this form of organisation.
3. Compare the relative suitability of partnership and private limited company for organising a wholesale firm dealing in textiles.
4. What are the distinctive features of a joint stock company? Explain why private limited company form of business organisation is popular among businessmen?

5. Define private company. Discuss the special privileges and exemptions enjoyed by it.

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Lesson No. : 5

MEASURE OF SIZE AND FACTORS DETERMINING SIZE, OPTIMUM SIZE, THE TENDENCY TOWARDS LARGE SIZE

STRUCTURE

- 5.0 Objectives
- 5.1 Introduction
- 5.2 Concept of measure of size
- 5.3 Measure of size
- 5.4 Meaning of optimum size
- 5.5 Factors determining optimum size
- 5.6 Reconciliation of differentiating optima
- 5.7 The tendency towards large size.
- 5.8 Disadvantages of large firms
- 5.9 Summary
- 5.10 Keywords
- 5.11 Self assessment questions
- 5.12 References/Suggested Readings

5.0 OBJECTIVES

After reading this lesson, you will be able to-

- Measure of size and standards to measure the size.
- Concept of optimum size and factors determining optimum size.
- Economies available to a large firm.

5.1 INTRODUCTION

The size of the business unit is one of the important elements which determine its efficiency and profitability . The term '*size of a business unit*' refers to the scale of its operations. With a view to make the most effective and economical

use of the available resources, the entrepreneur establishing a new enterprise has to take careful decision about the scale of operations, that is, the size of the business undertaking he is establishing. For this purpose he has to assess the financial and other facilities he can command and then take a decision whether he should start on a large scale from the very beginning or be contented with a relatively small size with a plan to expand in future. Just as he has to decide about the exact size of his undertaking at the start on the basis of the major determining factors, while thinking of expansion also, he will have to give careful thought to certain factors which govern the profitability of the undertaking.

5.2 CONCEPT OF MEASURE OF SIZE

In an industry there are firms of varying sizes. The costs of production in these firms of different sizes vary. Economists are concerned with the best size of a business unit, that is, a firm in which the average cost of production per unit is the lowest. But while taking decision about the size of a business unit or scale of operations often the various terms such as the plant or the establishment, the firm and the industry are used in a confused way. To have clear understanding of the concept of the size of a business unit it is advisable to keep in mind the differences between these terms, i.e., the plant, the firm, and the industry.

The Plant : Plant or establishment means a factory, a mill or a shop. It refers to a place where goods are produced such as a cement pipe factory or where from goods are distributed such as a departmental store or where from the services are supplied such as the transport depot. The term plant includes not only the machinery and equipment installed in the factory building but also the workers employed therein.

The Firm : The term 'firm' refers to the business unit or undertaking which owns the plant (the factory, the shop, the warehouse or transport depot), controls and manages it. Thus, it is essentially a unit of control, ownership and management. The firm owns the land on which the plant or establishment is situated. It controls the workers employed in the plant, finances the needs of the plant, arranges for the marketing of goods produced (or purchased in case of selling shop) and bears the risks involved. Further, a firm may own only one plant or more than one plant.

The Industry : The term 'industry' is wider in coverage than the term firm. It includes all the firms owning, controlling and managing plants engaged in the production of similar products. For example, by sugar industry is meant all the firms which are engaged in the production of sugar. Similarly, the cotton textile industry is the aggregation of all the firms which own the plants producing cotton yarn and cloth.

5.3 MEASURES OF SIZE

Inspite of the lack of preciseness the following standards are used to measure the size of a firm :

1. *Capital Invested.* The amount of capital invested is one measure of size that can be used to compare the size of like and unlike firms. But the main difficulty of this measure is that accurate data concerning capitalisation are difficult to obtain. Due to the variation in the capital requirements of different units and their methods of financing, this measure is not much reliable.
2. *Value of the Product.* The second measure is the value of the products in terms of rupees turned out by a firm. This measure has the advantages of making all comparisons in terms of rupees. But difficulty arises in case of the fluctuating value of the product or if the comparison is over two periods of time, one of the rising

prices (boom) and the other of the falling prices (depression), because inspite of large volume of output during depression the value may be small whereas during the boom period even with relatively small output value may be big.

3. *The Number of Wage-earners Employed.* The third measure is the number of wage-earners employed by each firm. This measure is much used and is advantageous in the comparison of the firms of similar nature. However, in case of its application to unlike firms results may be misleading . Also, it can be used only for the firms at the same stage of development because as firms grow in size all of them may not employ increasing number of workers, some may actually instal more machines for increased production rather than increasing their labour force.

4. *Power Used.* The amount of power used per unit is also "an index of the size and growth" of firms engaged in manufacturing. However, the amount of power consumed may be more or less even due to the factors other than the scale of operations of a firm. Therefore, it may not always prove to be a reliable measure.

5. *Amount of Raw Materials Consumed.* In case of the firms whose output are of similar nature the annual consumption of raw materials by a firm may be a good measure.

6. *Volume of Output.* This is a good measure of size in case of firms producing products which are uniform or homogeneous in nature or characteristics. But it will not give perfect picture in case of the firms which produce variety of goods such as is the case with the cotton textile industry.

7. *Productive Capacity of the Plant.* This is a good measure of size especially for the industries producing a variety of products. For example, number of plants in case of iron and steel industry with their productive capacity may provide a good standard of measure.

5.4 THE CONCEPT OF OPTIMUM SIZE

For any industry during a given period of time, there is a particular size of business unit which is found functioning somewhat more efficiently than a unit of slightly bigger or smaller size. This size is called the *optimum size*. It is at this point of size which in existing conditions or technique and organising ability has the lowest average cost of production per unit. Further, beyond this point any further expansion of size the law of decreasing return would start operating.

In an ideal world all firms should grow upto the point at which they are making the most effective and economical use of productive resources. That is to say, all firms should expand until they reach their optimum size. The concept of optimum size signifies the conditions under which a firm can conduct its affairs with minimum costs and maximum results. The term optimum literally means the conditions that produce the best result. The size of firms depends on the nature of industry. For example, in case of steel, automobiles, oil refineries one can find giant-sized companies, whereas in the field of agriculture, personal services etc. there are small units.

5.5 FACTORS WHICH DETERMINE THE OPTIMUM SIZE

The factors that determine the optimum size of the business units are studied under the following five groups:

5.5.1 Technical Factors

Technological factors underline the need for enlarging the scale and size of operations of a firm. Production processes are organized on large-scale and operated on specialized functional basis in order to realize to the full extent the technical advantages. Working of machines with all their capital and operational cost will be economical and productive only if production is planned on a large scale.

Plant, tools, equipment, etc. required for the engineering side of the productive operations will justify the heavy investments made therein only if they are utilised to their rated capacity. Unutilised or idle capacity will mean higher burden of costs. Hence the firm has to increase the scale of its operations in order to spread the overhead costs over a large output. When more output is turned out with the fuller utilization of technical avenues, the costs per unit would be lower. A large-sized firm is in a position to reach towards the technical optimum mainly by the following methods:

(i) Division of Labour, and

(ii) Integration of Process

(i) **Division of Labour:** Division of labour or the principle of specialization is a key to large-scale production. It means dividing the task into different processes or elements and assigning each process or element to a particular person instead of entrusting the entire task to one individual.

As Adam Smith illustrated, the pin-making job is divided into 18 distinct operations and each operation is looked after by separate person. Shoe-making, automobiles, radio-sets, watches etc. pass through hundreds of hands specialising in only one aspect of the total operations. Division of labour increases the dexterity in workmanship, results in saving of time and leads to invention of machines.

A large firm can employ specialised personnel to handle the functionally designed and laid out plant and equipment. Division of labour paves the way for technical advances and reduces or lightens the burdens of labour. Mechanical operations in varied tasks are justifiable only when production is on sufficiently large scale so that additional capital costs are fully covered by the saving in labour costs. A small firm cannot afford to instal and operate large machine because that

would mean heavier capital cost, higher interest charge, greater replacement costs as well as more recurring expenses on its specialised staff for operations and maintenance. A large-sized firm can acquire large machines, keep them in operation to full capacity so that larger output can be turned out at lowest average cost through versatile technical methods.

(ii) **Integration of Process :** Technical economies can also be realised by a large firm through integration of process. It means linking of processes and stages in production through devising large machines. Large machines take over the tasks being hitherto performed by different small machines and manual operations.

For example, operations of the production of pit iron, raw steel, semi-finished steel, steel castings and steel products may be so organised that the entire process is completed in one continuous sweep by a large machine. Two or three consecutive processes can be performed by a single machine thus eliminating labour required to set the work on different machines. It is only the large firm which can adapt expensive machinery for full scale operations. Thus the technical optimum depends on :

- (a) use of machines to replace human efforts;
- (b) continuous use of machines upto the installed capacity and further expansion of the scale of production, if necessary;
- (c) larger output and reduced costs per unit;
- (d) integration of process by devising complicated multi-process machines;
and
- (e) standardisation of products.

5.5.2 Managerial Factors

The technical benefits of division of labour and integration of process can also be realised by larger firm in the sphere of management. The superior technology and the engineering side of an undertaking would be of no avail if the management is not competent, responsive and economical from the cost point of view. The success of firm is not decided by the size of investments of assets acquired but is hinged on the managerial ability of the man at the helm of affairs of the firm. The influence of management on the size of the undertaking can be analysed in terms of specialisation and integration.

Management is concerned with planning, organising, co-ordinating the activities and motivating and controlling the personnel specially drafted for various operations. A large firm can give functional bent to management. It can divide the functions of management into many sections or departments. A large firm can also get the services of splendid organiser, technical genius, financial wizard, industrial psychologists etc. and with their combined knowledge experience and guidance, it will be possible to produce a better article, cheaper and more profitable than the small firms could have done independently.

Gains from Managerial Division of Labour

Managerial division of labour confers the following gains on the large firm:

1. Gains Through Specialisation

(a) Specialisation can be built into the varied delicate processes and tasks of management. Special talents can be given full scope for intelligent planning, skilful execution and masterly organisation. Qualified executives and experts will be freed

from the routine matters, clerical details, etc. that can be handled by other staff of average abilities. Planning and executing are separated in a large firm leading towards prompt, accurate and better work.

(b) There will not be overloading of duties and hence each will be able to give concentrated attention on the job assigned to him and develop his faculties and talents to the fullest extent.

(c) The workers and the subordinate staff in a large firm can carry out the work without interruptions because the higher levels of management will have formulated master plan and operational plans to direct the course of the job and will have made arrangements for tools, materials, etc. necessary for performing the job.

(d) A large firm can expand its activities without perceptible difficulty if it has already a competent cadre of experts, accomplished executives and administrative officers. The costs of management will not increase unit-wise as the firm goes on expanding its scale of operations. If more officers are to be appointed, additional expenses thereof would be more than covered by additional efficiency in business planning and performance.

2. **Gains Through integration** : On the managerial side also, integration of processes can be thought of to some extent to economise costs and enhance efficiency. On the technical side, large multi-purpose machines handle the 'complex' of many operational processes. On the management side, however, man counts more than the machine. Human ability, calibre, skill are more significant in managing a firm. But now a days machines have crept into administrative channels and have replaced quickly a few tasks which were being hitherto handles by the human efforts.

Office appliances, typewriter, dictating machines, accounting machines, address graphs, calculating machines, etc. have made the work more accurate, quick

and reduced the botheration of clerical routine. Even the intellectual aspects of administration, planning, policy -making etc. are being tackled by computers, cybernetical devices. Automation, robot systems represent the integration of administrative processes.

Thus optimum managerial unit is attained by:

- (a) functional arrangement of activities and allocation of tasks to respective specialists;
- (b) expansion of business operation on a scale sufficient to make fuller and continuous use of the services of experts and executives in the management hierarchy;
- (c) increase in the efficiency so as to spread over the higher cost of top and expert management on larger and better output; and
- (d) adoption of time-saving mechanical appliances to aid in the performance of managerial or administrative functions.

5.5.3 Financial Factors

Financial factors influence the size of the firm through the rates of interest at which it can borrow and the amounts which they can obtain at a given rate. Depending on the circumstances, a firm may sometimes borrow small amounts at a favourable rate of interest or at other times borrow small amounts at less favourable (higher interest) rate but larger amounts at more favourable (lower interest) rate. The conditions in the capital market, business record of the firm, its likely prospects, the nature of industry, the profits it has earned, etc. determine the ability of the firms to raise funds required by them. Small firms including sole proprietorship are not able to mobilize sufficient funds for expanding their business. Large firms,

particularly joint-stock companies with limited liability are able to build up their business by the proceeds of public issue of shares and debentures.

The growth of sole traders, partnership firms and private limited companies is hampered by their relatively lesser capacity to raise the financial resources whereas public limited companies have wider scope for mobilising capital in forms of different types of shares and debentures subscribed to by public. In raising the capital by public subscriptions, large firm has an advantage because of its high standing and reputation amongst the investing public.

Large firm may build up its financial strength by adequate reserves. Small firms may lapse into instability if they have no sufficient reserves to face any contingency. Large firms have better staying capacity in times of depression and emergency. In a large firm it is possible to plough back a portion of divisible profits to finance new ventures or expansion. A large firm with multiple product or services will find it convenient to finance one aspect of its activities by another. Large firms can borrow easily, readily and on competitive rates from banks to meet their-term needs of working capital. Banks prefer large firms as their loanee-customers because their size gives an impression of solidarity and security. Banks hesitate to finance small firms on adequate scale. Financial factors inhibit the growth of small firms while they provide incentive for a large firm to expand still further.

Thus, on financial side also large firms have their dominant position. While they can raise the capital or borrow funds whenever required. It should be ensured that the funds are profitably employed for conducting the business on suitable scale. Otherwise large firms have to face the burden of interest rates and repayment schedule if funds remain idle or if they are not fruitfully employed.

Financial optimum is attained by a large firm in the following ways :

- (a) By accurate financial planning, determining the short-term and long-term capital requirements on the basis of existing state of business and expected changes therein;
- (b) By avoiding over-capitalisation and under-capitalisation so that capital raised is represented by equivalent value of productive assets;
- (c) By selecting the proper timing and method of issuing shares, debentures, etc. so that more funds can be raised at economical rates;
- (d) By making adequate provision for contingencies, depreciation, bad debts etc. repayment of old loans, periodical payment of interest on loans raised, etc.; and
- (e) By adopting budgetary control, accounting and auditing to ensure proper use of funds and preventing misappropriation.

5.5.4 Marketing Factors

Marketing factors influence decisively the size of the firm and the scale of operation. The economies of scale are clearly marked in the marketing processes of a large firm. From the point of cost factor, optimum point in respect of marketing operations is attained by a firm through the conduct of its marketing operations on sufficiently large scale consistent with its production and sales potential. Marketing has two basic facets – buying and selling. A firm has to buy carefully the required raw materials, stores, tools etc. in time and in proper bulk so that production process continues unhampered.

The quality of the final product depends to a large extent on the quality of materials used in its manufacture. The price of the final product also is determined by the cost of materials bought.

Adequate and timely purchase of materials at economical prices will be a necessary condition for the schedule-wise manufacture of goods and their scale in the market. Hence buying influences the size of a firm. Need for economical buying creates tendency towards the increasing size of the firm. Advantages of Large-Scale Buying are as follows :

1. A large firm can buy bulk of commodities in a single order or deal. Sufficient stock of materials can be built up by a large firm so that manufacturing will proceed unhindered. A small firm is not in a position to buy large stocks of materials at a time and hence it is more likely to run short of the materials as compared to a larger firm.
2. Through its bulk purchases, a large firm can bargain with the seller and obtain the supplies at cheaper rates as higher rates of discounts on larger volume of purchases are offered by sellers.
3. Large firm being one of the dominant customers of raw materials, suppliers can secure continuous supplies and other concessions in packing, forwarding charges, terms of payment, etc.
4. Large firm has strong bargaining power. Small firms are forced to buy in small lots while large ones can compel the sellers to quote economical or cheaper rates and terms because they can afford to buy in bigger lots.
5. A large firm can realise economies in transport, handling and storage expenses because of the bulk purchases.

The large firm however will have to suffer hard if there is slight error in the judgement of experts. Small firms can readily correct the error without affecting market trends.

Small firms, however, can get over the disadvantages of limited buying and seek to realise the economies of large -scale buying through vertical integration by common agreements, using facilities of produced exchanges, etc. But such common agreement for collective buying will not be practicable all the times and small firms also may not be in a position to get facilities of organised markets in respect of all types of raw materials. Hence large-scale buying is by and large more economical.

Large-Scale Selling : Selling is obviously the most critical aspect of a firm's working. The quantum of sales, the rate of sales turnover, wider coverage of market, selling expensive etc. exert far-reaching influence on the size of the firm. More and quicker sales, highest possible prices and minimum costs of selling are the aims of every firm. Large-sized firm has certainly advantages of wider sales and spreading over of selling expenses. These are as follows.

- (a) Large firm may produce sufficient output and keep adequate stocks for continued inflow into the market. Demand goes on varying from time to time. Large firm can adjust its production schedule and stock positions according to the changes in the level of demand.
- (b) A large firm can meet any emergency demand for goods through adequate reserve stocks and ready productive capacity.
- (c) A large manufacturing firm or a bigger trader can afford to carry a large variety of stocks and attract customers by the wider range of choice offered. A large firm can expand in different lines and offer wider choice of variety of goods. This induces larger orders from larger number of customers.
- (d) A large firm can extend the tentacles of its selling to even foreign markets.

(e) Large firms can carry on extensive advertising campaigns to create, promote or expand sales of their products in different markets and have the capacity to spend sufficiently on advertising and the sales-promotion efforts.

(f) A large firm can maintain its selling organisation to promote sales. They may set up their own sales depots, distribution centres, emporia, etc. and approach the customers more quickly and extensively. Thus marketing optimum is attained by a large firm through organising its buying and selling operations on large scale.

The marketing optimum depends on the extent to which a firm can buy in bulk at cheap rates and sell in bulk with least selling expenses.

5.5.5 Factors of Risks and Fluctuations

Risks and uncertainties are the part and parcel of industrial organisation. Firms have to face fluctuations in demand for their products and accordingly adjust their policies and strategies in order to survive and maintain their position in the market. Risks of changes in demand have their impact on the trends in the size of firms. The firms should have the necessary strength to absorb the shocks of fluctuation in demand and they should be flexible enough to adapt to new trends in demand. Size of a firm should be such as to enable the firm to 'stay on' despite the rough tides of fluctuations, at the same time the bulkiness of its size should not hinder its adjustability and adaptability to new trends in the market. The following are the reasons for variations in demand :

a) *Permanent change* in demand may occur due to decline in the popularity of a product or appearance of a direct substitute. It may also be caused by changes in fashion, tastes, technology or methods of production, so that the product of a firm was so far producing becomes out of date and hence unsaleable. The firms engaged in production of such goods have to reorganize their production structure to cater

to the changed demand and adopt new technology. If the firm has versatile machinery capable of producing alternate models of articles, then adjustments would be easier. But if the machines are rigidly specialised, then, permanent changes in demand would involve heavy cost of reorganization. Old machinery has to be scrapped and new plant and machinery have to be installed.

b) *Cyclical variations* in demand mean imbalance in demand and supply for a short period. Trade cycles involving alternative phases of boom and depression are common phenomena in the economic structure based on free enterprise system. During depression, demand declines and there is glut of goods or unsold stocks pile up. Prices sharply decline and the firms find their revenue dwindling. Small and weak firms with meagre reserves are hard hit by depression and many of them may be closed down.

Large firms can pull through the depression period. But if they are compelled by circumstances to curtail their output, they are at a disadvantage because costs per unit increase due to shortfall in capacity-utilization. Trade cycles many a time lead to amalgamation of firms so as to face the impact in concerted manner.

(c) *Seasonable variations* i.e. seasonal changes in demand for certain products, for example, higher demand for woolen goods in winter. Off season slackness in demand is matched by firm providing for production of different products. Another product may be engaged and developed to be manufactured in combination with seasonally demanded product. The demand for the new product may also be seasonal but their seasonal periods are different, for example, summer and winter clothes may be produced at the same time.

(d) *Erratic variations in demand*, These occur in industries where products are not manufactured according to standardised pattern but where products are turned

out as per individual orders and designs at different prices. For example, shop sign boards, special furniture, jewellery, visiting card, etc. are irregularly produced as per the adhoc demand. Thus there are problems of idle capacity of firms engaged in production of such goods during the intermittent periods when there is demand.

To reduce the burden of overhead cross, such firm can go in for production of continuously demanded product. The profits are earned mainly by the sale of the main product as per special demand while the secondary products may be manufactured merely to cover the costs of production and keep the factors engaged.

It can be concluded that existence of risks does not favour larger size of the firm. Only when individual units seek to act in concert for reducing the intensity of adverse effects of permanent and cyclical variations in demand, there may be tendency toward larger size. Where monopolies are intended to be formed to face the risks, there would come into existence units of larger size.

But since we are viewing the firms operating under normal competitive conditions, we can conclude that risks and fluctuations in respect of demand favour small firms as they can adjust with least costs and dislocation.

5.6 RECONCILIATION OF DIFFERENTIATING OPTIMA

It is not always that the firm attains optimum results in all aspects of its operation and administration. It is possible that a firm which has attained optimum size on the technical side is yet to reach the point of optima on managerial, financial or marketing side. Hence the size of a firm depends on the "compromise between the optima set by managerial, technical, marketing and financial factors." The firm shall have to expand until the average costs are minimum on the whole. When a firm experiences differing optima, it can plan its growth in the direction of reconciling the varying optima.

Methods of Reconciliation

1. If the technical optimum is greater than the managerial optimum, the gap has to be covered by measures aiming at enhancing managerial efficiency. Or the firm has to split the productive organisation into different separate departments in order to take advantage of the higher technological potential.

If it is not technologically feasible to departmentalise, then, an attempt should be made to reduce the size of the technical unit to manageable proportions. If management difficulties hinder technological economies the firm should think of concentrating on limited specialised range of commodities and more firms may be set up to manufacture other models of commodities. For example, large iron and steel units may be split into independent compact units, if management of giant steel factory is found unwieldy.

Vertical disintegration is one of the effective remedies to reconcile the technical and managerial optima. The processes are separated into smaller industrial units whenever technical optimum is beyond the managerial optimum. Even large firms which want to be self-sufficient may have to go in for contract purchases of certain materials from outside firms specialising therein. All the firms, small or big, can operate on their own best scale if there are mutual deals between them.

2. If the managerial optimum is larger than the technical optimum, there should be multiplication of technical units. Advantages of large-scale management can be realised by establishing small technical units at different places. Orders are distributed to individual plants at different places by the central management. Multiplicity of small technical units operating under central management will also be a safeguard against cyclical, seasonal variations in output and demand.

3. If the marketing optimum is larger than the technical optimum, the firm may go in for a line of different articles which can be sold together. It may sell the articles produced by other firms in addition to its own products. For example, a book publisher may sell not only his own publications but also the books published by the other firms, so that he can avail of marketing economies.
4. If the marketing optimum is smaller than the technical optimum, then the firm can continue to operate on larger technical scale but can entrust the marketing responsibility to dealers, agents and merchant middlemen like wholesalers, sole distributors, etc.
5. If financial optimum is larger than the managerial optimum then independent units may be established with financial arrangements and employing qualified people conversant with problems of large concerns.

5.7 THE TENDENCY TOWARDS LARGE SIZE

The size of the firm is one of the decisive factors in the achievement of efficiency in its operations. In these days, large-scale production is considered to bring most economic results by the way of lower costs and higher returns. Therefore, there has been a tendency towards increase in the size of the industrial units in order to organise mass production and bulk sale in diversified markets. The increasing scale operations bring economies in all sphere of the functioning of the firm. Different economies available to a large firm are :

5.7.1 Technical Economies

1. Large firms can install new machines, automatic appliance and adopt other means of superior technology because it is economical to do so if they are set for large-scale production.

2. Large firms can reap the full benefits of specialisation through scientific division of labour.
3. Large firms can afford to earmark funds for conducting technological research and experimentation in order to find out better and cheaper methods or production.
4. Large firms have adequate resources to enjoy the services of experts, to plan, guide and execute the manufacturing operations without any hindrance.
5. Large firms can also realise economies from bulk purchase-contracts for building up adequate stocks of raw materials etc. so that the continuity of the firms's operations is not disturbed .
6. Large firms can think of utilising by products, acquiring patent rights over innovations, etc.

5.7.2 Managerial Economies

1. A large firm can employ managerial experts at the top level of management so that the firm functions efficiently under rational regulation. Complicated problems of finance, labour, marketing, administration can well be tackled by managers of superior attainments. Such brilliant executives can be appointed by large firms, since they have adequate resources to pay them and their scale of operations being large there will be sufficient work for them.
2. Large firms are in a position to introduce modern appliances like calculating machines, dictating machines, computers, etc. to save time and to improve the services to the customers.
3. Large firms would be able to introduce elaborate division of labour in functional arrangement of business activities of the firm.

4. Large firms can go ahead provided they have already qualified cadre of managerial executives and experts.

5.7.3 Financial Economies

1. Large firms can have greater access to money and capital markets. They can mobilise resources on easy and economical terms regarding rate of interest, repayment of borrowed money etc. through banks and other financial institutions
2. Large firms can set aside sufficient amount for depreciation and replacement of assets.
3. They can adopt new techniques of planning and proper control of utilization of funds through budgeting, costing, management, accounting etc.
4. Large firms can afford to plough back substantial part of their profits for further expansion.

5.7.4 Marketing Economies

1. Large firms can realise economies arising from bulk sales. Marketing costs in case of larger volume of sales would be relatively less per unit of output.
2. Large firms can make use of services of experts in marketing.
3. Such firms can afford to spend sizable amount on advertising and undertake sales promotion efforts so as to step up the rate of turnover.
4. If a firm is handling different lines of products, the same salesmen can canvas sales of the different products without additional costs.
5. Large firms can render better services to customers and build up goodwill and business prestige.
6. Large firms can withstand competition in the market

In short , because of the economies explained large firms will be in a better competitive and bargaining position compared to small firms. Lesser costs, higher production, larger sales, superior techniques, better services, surer stability are the advantages of large firms.

5.8 DISADVANTAGES OF LARGE FIRMS

Notwithstanding the various economies enjoyed by the large firms there are certain limitations inherent with their size. Large firms suffer from following limitations because of their size and the difficulty in tackling the technical, managerial and human problems arising therefrom:

1. Large firms tend to be bureaucratic and there may be red tapism in its administration
2. There is no scope for personal initiative, enterprise and skill since the administrative and operational procedures are minutely standardised.
3. In case of large firms it is not possible to develop personal contact with the customers.
4. Existence of large firms lead to concentration of economic power within few hands.
5. Large firms tend to grow monopolistic through consolidation or integration.
6. Oligarchic hold of large firms over the economy leads to exploitation of consumers in the form of higher prices, abnormal profits, artificial costs in supply etc.
7. It becomes unwieldy to manage large-sized firms due to difficulty of coordination and control.

8. In times of cyclical fluctuations or in the event of sudden or swift changes in the trends of demand or in technology, large firms find it hard to adjust their organisations to new situation.

5.9 SUMMARY

The size of a firm is one of the decisive factors in the achievement of efficiency in its operations. In these days, large-scale production is considered to bring most economic results by the way of lower cost and higher returns. Therefore, there has been a tendency towards increase in the size of the industrial unit. We see, therefore, firms of different sizes, each attempting to expand depending on its resources and business potential. However, all the firms may not be able to operate with equal efficiency. The generally accepted norm in modern economic analysis is that as the firm's business goes on expanding, the cost per unit would be declining. Therefore, all firms tend to expand their scale of operations in order to spread over their costs over larger output. But there is a limit upto which they can grow without adverse effect on its profitability. Growth beyond that limit may give decreasing return per unit of investment due to managerial and financial strains. Economists call that limit the optimum size.

5.10 KEYWORDS

Division of labour: It means dividing the task into different processes or elements and assigning each process for element to a particular person instead of an entrusting the entire task to one individual.

Firm: The term firm refers to the business unit or undertaking which owns the plant (the factory, the shop, the warehouse, etc.), controls and manages it.

Industry: It includes all the firms owning, controlling and managing plants engaged in the production of similar products. For example, sugar industry means all the

firms which are engaged in the production of sugar.

Plant: Plant or establishment means a factory, a mill or a shop. It refers to a place where goods are produced such as cement, pipe factory or wherefrom goods are distributed such as a departmental store or wherefrom the services are supplied such as the transport depot. It not only includes machinery and equipment installed in the factory building but also the workers employed therein.

5.11 SELF ASSESSMENT QUESTIONS

1. What are the standards used to measure the size of a firm ?
2. What is meant by optimum firm ? What is its utility in business decisions?
3. "Marketing factors have the most radical decisive effect on the size of a firm". Explain.
4. How do risks and fluctuations affect the optimum size of a firm ? How can their effects be mitigated ?
5. "Large firms are considered to bring most economic results by the way of lower costs and higher returns". Comment.

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Lesson No. : 6

SHAREHOLDERS, BOARD OF DIRECTORS, CHIEF EXECUTIVE AND MANAGING DIRECTOR

STRUCTURE

- 6.0 Objectives
- 6.1 Introduction
- 6.2 Distinction between shareholders and members
- 6.3 Who can become member ?
- 6.4 How to become a member ?
- 6.5 How is membership terminated ?
- 6.6 Board of directors
 - 6.6.1 Number of directors
 - 6.6.2 Appointment of directors
 - 6.6.3 Vacation of director's office
 - 6.6.4 Removal of directors
- 6.7 Managerial remuneration
- 6.8 Meetings of directors
- 6.9 Powers of board.
- 6.10 Managing director
- 6.11 Summary
- 6.12 Keywords
- 6.13 Self assessment questions
- 6.14 References/suggested readings

6.0 OBJECTIVES

After reading this lesson, you should be able to-

- Make distinction between shareholder and members;
- Understand how to become a member and how is membership terminated;
- Know how directors are appointed and how they can be removed;

- Understand what are the powers of board of directors; and
- learn about the provisions relating to appointment and disqualification of managing director.

6.1 INTRODUCTION

A company is composed of members, though it has its own entity distinct from members. The term 'member' refers to a person whose name appears on the register of members. On the other hand, the term 'shareholder', refers to a person who holds shares in a company.

The terms 'member' and 'shareholder' have been used interchangeably in the Companies Act. The word 'shareholder' is used in relation to a company having a share capital and there can be no membership except through the medium of shareholding. A holder of shares becomes a member only when his name is entered on the register of members. But the term 'member' is wider in scope and may be used in relation to all types of company. A person may become a member of a company without holding any share. Companies limited by guarantee or unlimited companies which may not have share capital, and therefore can have no shareholders but they do have members.

6.2 DISTINCTION BETWEEN SHAREHOLDERS AND MEMBERS

A shareholder may be distinguished from a member as follows :

1. A holder of a share warrant is a shareholder but not a member as his name is struck off the register of members immediately after the issue of such share warrant.
2. A registered shareholder is a member but a registered member may not be a shareholder, because the company may not have a share capital.

3. The transferor or the deceased person is a member so long as his name is on the register of members whereas he cannot be termed a shareholder.
4. Similarly, a shareholder by transfer is not a member until his name is entered in the company's register of members.

6.3 WHO CAN BECOME A MEMBER ?

The general rule is that any person who is competent to contract may become a member. A contract to purchase shares is like any other contract and both the contracting parties must be competent to enter into the contract. The provisions of the Indian Contract Act, 1872, regarding the persons who can contract would apply. This is, however, subject to the provisions of the memorandum and articles of the company. The articles may provide that certain persons cannot become members of the company. The membership rights of some categories of person are discussed below :

Minor : A minor in India cannot be a member because a contract with a minor is absolutely void. Neither a minor nor his legal guardian can be made responsible for the payment of calls. Under the English law, a minor can be a member of the company because a contract with a minor is voidable and not void. A minor in India may apply for and receive an allotment of shares subject to a right to repudiate liability on them before or within a reasonable time after attaining full age.

Company : A company is a legal person and hence is competent to contract. Therefore, it can become a member of another company. But it can invest money in another company only if it is so authorised by its memorandum of association. But a company cannot be a member of itself.

Subsidiary company : A subsidiary company cannot be a member of its holding company. Any allotment or transfer of shares in a company to its subsidiary is

void. This provision will not apply where the subsidiary is the legal representative of a deceased member of the holding company or a trustee and the holding company is not beneficially interested under the trust.

Partnership firm : A partnership firm, being not a person in the eyes of law, cannot be a member of a company. However, a firm can purchase shares of a company in the individual names of its partners as joint shareholders. A firm may be a member of a non-profit making company licensed under section 25 but on its dissolution the membership ceases.

Foreigners : Foreigners can become members of companies registered in India but permission of the Reserve Bank of India under the Foreign Exchange Management Act (FEMA) has to be obtained for this purpose. This right of the foreigner as a member will be suspended if he becomes an alien enemy.

Fictitious person : A person who takes the shares in the name of fictitious person becomes liable as a member. Besides, such a person can be punished for impersonation under section 68-A.

Insolvent : An insolvent cannot become a member of the company, but if a member has become an insolvent, he remains a member as long as his name appears in the register. However, the trustee in bankruptcy may get his name registered as the proprietor of the shares.

Minimum number of members : According to section 12 of the Companies Act, any seven or more persons in the case of a public company (two or more persons in the case of a private company), associated for any lawful purpose may by subscribing their names to a memorandum of association and otherwise complying with the requirements of the Act in respect of registration, can form an incorporated company, with or without limited liability.

Maintenance of minimum number : When a public company carries on business with less than seven members (two in the case of a private company) every member who knows of this fact will become liable to an unlimited extent for all the debts contracted by the company in so carrying in business beyond the period of six months after the number has so fallen. (Sec. 45). The reduction of number of members below the minimum will make the company liable to be wound up under Section 433.

Maximum number of members : The maximum number of members of a private company is limited to fifty excluding the present and past employees of the company who continue to be the members of the company. There is no restriction with regard to the maximum number of members of a public company.

6.4 HOW TO BECOME A MEMBER

A person may become a member of the company in any of the following ways :

1. By subscribing to the memorandum of association.
2. By agreeing to take qualification shares.
3. By application and allotment.
4. By transfer of shares.
5. By transmission of shares.
6. By holding out as a member.

1. Membership by subscription (Sec.41) : Every subscriber to the memorandum of association is deemed to have agreed to become its member and on its registration must be put on the register of members. Two conditions are necessary to make such a person as a member : (i) He will subscribe his name to the memorandum of association; (ii) The company must be registered under the Companies Act. Thus, the signatories to the memorandum become members of the company simply by reason of their having signed the memorandum. Neither an

application form nor allotment of shares is necessary for becoming a member in this case.

2. Membership by qualification shares (Sec. 266) : Directors of the company on delivering to the registrar written undertaking to take their qualification shares and to pay for them become members of the company, and they are in the same position as if they were subscribers to the memorandum. They are deemed to have become members automatically on the registration of the company.

3. Membership by application and allotment : A person may become a member of a company by an application for shares subject to the formal acceptance by the company. The ordinary law of contract applies to the agreement to take shares in a company. An application for shares may be absolute or conditional. If it is absolute, a simple allotment and notice thereof to the applicant will constitute the agreement. If it is conditional, the allotment must be made on the basis of the conditions specified. Where there is a conditional application for shares and an unconditional allotment, there is no contract constituted.

Example : R agreed to take shares in a company provided he was appointed local manager of the company. Shares were allotted to him but he was not given the appointment. R refused to take the shares. It was held that R was not a member as his application was conditional and allotment was unconditional. (Roger's case (1868) L.R. 3Ch. 633)

4. Membership by transfer : Shares in a company are movable property and are transferable in the manner as provided in the articles of the company. A person can become a member by acquiring shares from an existing member and by having the transfer of shares registered in the books of the company. As long as his name is not entered in the register of members, he is not a member. He does not acquire

the status of a member merely by purchasing shares. Accordingly if the shares purchased by him have been forfeited by the company, he cannot challenge the validity of the forfeiture.

5. Membership by transmission : On the death of a member his shares vest in his legal representative. The legal representative can sell the shares without being registered, but subject to the provisions of the articles he is entitled to be put on the register of members if he so chooses. The official assignee is likewise entitled to be a member in place of a shareholder who is adjudicated insolvent. This process of acquiring membership is known as transmission. It takes place on the death or insolvency of a member. In these cases no instrument of transfer need be delivered to the company. If a company without any reason refuses to accept a transmission, the same remedies are available as in the case of a transfer.

6. Membership by holding out : A person is deemed to be a member of the company who allows his name to appear in the register of members apart from any agreement to become a member, to be on the register of members or otherwise holds himself out or allows himself to be held out as a member. A person may not have applied for the shares but if he assents to his name being on the register, he is to be considered as a member of the company. However if his name has been entered in the register of members improperly, he can escape liability by taking prompt action to have his name removed from the register on some permissible ground.

6.5 HOW IS MEMBERSHIP TERMINATED

Membership of a person is terminated when his name is removed from the register of members. This may result from some act of the member or sometimes from the operation of law. It may occur in any of the following ways :

1. When a person transfers his shares to another person and the company

- registers the transfer, the transferor ceases to be a member when his name is removed from and the transferee becomes a member when his name is entered in the register of members.
2. When the shares of a person are forfeited by the company due to non-payment of allotment or call money.
 3. When a company issues share warrants in exchange for fully paid shares to a member, he ceases to be a member.
 4. When surrender of shares is permitted and a person voluntarily surrenders his shares to the company.
 5. When redeemable preference shares are redeemed by the company.
 6. When a member rescinds the contract to take the shares on the ground of fraud, misrepresentation or a genuine mistake.
 7. When a person is adjudged insolvent and the official assignee or receiver disclaims his shares and his name is removed from the register of members.
 8. When a person dies. But his estate remains liable for calls until the registration of the shares in the name of the legal representative.
 9. When the company is wound up, membership is terminated. But a member at the time of commencement of the winding up proceedings remains liable as a contributory and in case of surplus if any, he is also entitled to a share.
 10. When his shares are sold under the order of the court under section 402 of the Companies Act.

6.6 BOARD OF DIRECTORS

A company is an artificial person existing in the eyes of law. It has neither a body, nor a soul, nor a conscience; nor is it subject to the limitations of

the body; even then it exists. It is only a legal person. As such, it can not act in its own person. This makes it necessary that the company's business should be entrusted to human agents. These agents are known as directors. Directors are the persons who manage the affairs of the company. They are collectively known as the board of directors or board. If we assume the company to be a body, the directors are its brain. The company can and does act only through them.

The directors are the elected representatives of the share holders. They are the persons to whom the company delegates most of its powers through the memorandum and articles.

Persons deemed to be directors : According to explanation (1) of Section 303, any person in accordance with whose directions or instructions, the Board of directors of a company is accustomed to act shall be deemed to be a director of the company, except when the Board of directors so acts on advice given by him in a professional capacity.

Only individuals to be directors : No body corporate, association or firm shall be appointed director of a company and only an individual shall be so appointed (Section 253). It is because that the office of a director is to some extent an office of trust. There should be somebody readily available who can be held responsible for the failure to carry out the obligations of such an office. It will be difficult to fix the responsibility if the director is a body corporate, association of persons or firm.

6.6.1 NUMBER OF DIRECTORS

According to Sec. 252 every public company (other than a public company which has become such by virtue of Section 43-A) shall have at least three directors and every other company shall have at least two directors. The

directors of a company are collectively referred to in this Act as the board of directors or the board. Subject to the minimum number of directors as statutory required, the Articles may prescribe the maximum and minimum number of director for its board. A company in its general meeting may, by ordinary resolution, increase or reduce the number of its directors within the limits fixed in that behalf by its Articles. According to Section 259 of the Act, any increase in the number of directors beyond the maximum limit fixed by the articles, must be approved by the central government, except where the increase does not make the total number of directors more than 12.

6.6.2 APPOINTMENT OF DIRECTORS

The success of a company depends to a great extent upon the competence and honesty of its directors. It is, therefore, desirable that the administration of companies should be in right hands. The appointment of directors is accordingly regulated by the Act. Directors may be appointed in the following ways :

1. By the articles as regards first directors (Section 254).
2. By the company in general meeting (Sections 255 to 257, 263, 264)
3. By the directors (Section 260, 262, 313).
4. By third parties (Section 255).
5. By the principle of proportional representation (Section 265).
6. By the Central Government (Section 408).

1. **First Directors :** The first directors are usually named in the articles. The articles may also provide that both the number and the names of the first directors shall be determined in writing by the subscribers to the memorandum or a majority of them. Where the company has no articles or the articles are silent regarding the appointment of directors, the subscribers to the memorandum who are individuals shall be deemed to be first directors of the company. They shall hold office until the directors are appointed at the first annual general meeting.

If all the subscribers to the memorandum happen to be bodies corporate, none of the subscribers can be deemed to be directors and the company will have no directors until the first directors are appointed under Section 255.

2. Appointment by company : Appointment of subsequent directors is made at every annual general meeting of the company. Section 255 provides that not less than two third of the total number of directors of a public company, or of private company which is subsidiary of a public company must be appointed by the company in general meeting. These directors must be subject to retirement by rotation. The remaining directors of such a company and the directors generally of a purely private company must also be appointed by the company in general meeting. In other words, not more than one third of the total number of directors can act as non retiring directors i.e. not subject to retirement by rotation.

Example : A company has six directors. It can appoint only 2 directors (one third of six) as permanent directors if it wants to do so. The remaining four directors shall be liable to retire by rotation.

3. Appointment of directors by the directors : Directors can be appointed by directors in the following circumstances:

i) As additional directors : According to Sec. 260, if the articles so provide, the board of directors can appoint additional directors. Such additional directors shall hold office only upto the date of the next annual general meeting of the company. However, the number of directors and additional directors together shall not exceed the maximum strength fixed for the board by the articles.

ii) In case of a casual vacancy : According to Section 262, if the office of any director appointed by the company in a general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy shall be filled

by the board of directors at meeting of the board. Any person so appointed shall hold office only upto the date upto which the director in whose place he is appointed would have held office if it had not been vacated as aforesaid.

iii) **Alternate director :** If authorised by the articles or by a resolution passed by the company in a general meeting, the board of directors of a company may appoint an alternate director to act for a director during his absence for a period of not less than three months from the state in which the meeting of the board are ordinarily held as per Section 313.

An alternate director so appointed shall not hold office as such for period longer than that permissible to the original director in whose place he has been appointed and shall vacate office as and when the original director returns to the state in which the meetings of the board are ordinarily held.

4. Appointment by third party : According to Section 255, if the articles so provide, third parties such as debenture holders, financial corporations, bankers etc. may appoint their nominees to the board of directors in certain circumstances. The number of such directors, however, shall not exceed one third of the total number of directors. But they will not be liable to retire by rotation.

5. Appointment by proportional representation : Normally, the directors are appointed on the basis of election by simple majority. In such a case even a substantial minority can not succeed in appointing even single director of their choice to the board. Section 265 was, therefore, enacted by the legislature so that minority may also have an opportunity of placing their representatives on the board. According to this section, the articles of a public company or a private subsidiary thereof may provide for the appointment of not less than two thirds of the total number of directors according to the principle of proportional representation whether by single transferable vote or by a system of cumulative voting or

otherwise. Such appointments are, however, to be made only once in three years and interim casual vacancies must be filled in the manner provided for in the articles. In the case of proportional representation, several directors can be appointed simultaneously.

6. Appointment by the Central Government : The central government has the power as per Section 408 to appoint directors for the purpose of prevention of oppression and mismanagement. This power comes into force when a petition has been made to the Company Law Board for prevention of oppression and mismanagement. The director can be so appointed on the application of 100 members or members holding 1/10 of the total voting rights. The Company Law Board may direct that until the appointment of the new directors, a certain number of persons would hold office as additional directors. On such a directive, the central government shall appoint additional directors. The term of the directors appointed by the central government shall not exceed three years at a time.

The directors appointed by the central government shall not be taken into account for the purpose of reckoning 2/3 or any other proportion of the total number of directors. These directors are neither required to hold qualification shares nor they are liable to retire by rotation. Such directors are required to keep the government informed of the state of affairs of the company to enable it to take appropriate action.

6.6.3 VACATION OF THE DIRECTOR'S OFFICE

According to Section 283, the office of a director shall be considered vacant if :

- i) He fails to obtain within two months time after his appointment, or at any time thereafter ceases to hold, qualification shares, if any required of him by the Articles of the company.

- ii) He is declared to be of an unsound.
- iii) He applies to be adjudicated an insolvent.
- iv) He is adjudged an insolvent.
- v) He is convicted by a court of an offence involving moral turpitude and sentenced to imprisonment for not less than six months;
- vi) He fails to pay any calls for a period of six months from the due date, unless exempted by the government.
- vii) He absents himself from three consecutive meetings of the board or from all meetings for a continuous period of three months, whichever is longer, without obtaining leave of absence from the board;
- viii) He or any firm in which he is a partner, or any private company of which he is a director accepts a loan or any guarantee or security for a loan from the company in contravention of Section 295.
- ix) He fails to disclose his interest in a contract as required by Section 299.
- x) He becomes disqualified by an order of the court under Section 203 for fraudulent conduct;
- xi) He is removed by means of an ordinary resolution before the expiry of his term;
- xii) Having been appointed a director by virtue of his being an official or employee of the company, he ceases to hold such office or other employment in the company.

If a person functions as a director when he knows that the office of director held by him has become vacant on account of any of the above mentioned

disqualifications, he shall be punishable with fine which may extend to Rs. 500 for each day on which he functions as a director.

6.6.4 REMOVAL OF DIRECTORS

The directors of company can be removed from their office in the following ways :

1. **Removal by the share holders :** According to Section 284, a company may by ordinary resolution remove a director before the expiry of his period of office. For such removal, a special notice shall be required to be served. However, a director appointed by the central government or a director holding office for life on 1st April, 1952 cannot be so removed. Those intending to remove director must give a special notice to the company at least 14 days before the meeting so that the company may notify the concerned director as well as the members. The director sought to be removed has a right to make a representation at the meeting.
2. **Removal by the central government :** Sections 388 B to 388 E empower the central government to remove the directors on the recommendation of the Company Law Board. The person so removed shall not hold the office of a director or any other office connected with the conduct and management of the affairs of the company for a period of five years unless the period is reduced. No compensation shall be payable to him for the termination of his office.

According to Section 388 B, the central government may exercise such power where, in its opinion, there are circumstances suggesting :

- i) That any person concerned with the conduct and management of the affairs of a company is or has been in connection therewith guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law, or breach of trust; or

- ii) That the business of a company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practice; or
- iii) That a company is or has been conducted and managed by such person in manner which is likely to cause, or has caused, serious injury or damage to the interests of the trade, industry or business to which such company pertains; or
- iv) That the business of a company is or has been conducted and managed by such person with the intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest.

3. Removal by the Company Law Board : According to Section 402, on an application made to the Company Law Board for the prevention of oppression or mismanagement, if satisfied, it may terminate the agreement of the company with the director. However, such termination can be done after the notice to the party concerned. The person so removed is disqualified from holding managerial office for a period of five years. He can also not claim any compensation for the loss of office.

6.7 MANAGERIAL REMUNERATION

As directors are not servants of the company, they have no right for payment unless it is provided in the articles. In the absence of an express agreement regarding remuneration, the director surrenders services to the company gratuitously and not for reward. The remuneration payable to the directors is determined by the articles of the company or by a resolution or if the articles so require by a special resolution passed by the company in general meeting. The

directors cannot themselves fix the remuneration of all or any one of themselves. Once the articles provide for remuneration it becomes a debt due from the company to the director and may be used for and may be paid out of capital if there are not profits, and like ordinary creditors can prove their claim in winding up of the company. But a director cannot claim preferential payment of fees owing to him as he is not servant of the company.

As per Section 198, the total managerial remuneration payable by a public company or private company which is subsidiary of public company, to its directors and its managing agent, secretaries and treasurer or manager in respect of any financial year shall not exceed 11% of the net profit of that company for that financial year. This percentage shall be exclusive of the fees payable to the directors under Section 309.

If in any financial year, a company has no profits or its profits are inadequate, a sum not exceeding rupees 50,000 per annum may be paid to all managerial personnel with the previous approval of the central government. The word remuneration shall include the following :

- i) Any expenditure incurred on providing free accommodation and other amenities connected therewith;
- ii) Any expenditure incurred on providing any other amenity either absolutely free or at a concessional rate;
- iii) Any expenditure incurred in providing any obligation or service which in the absence of provision by the company, would have to be borne by that person;
- iv) Any expenditure incurred in providing life insurance, pension, annuity or gratuity to such person, his spouse or child.

It is pertinent to note that according to Section 309, a whole time director or managing director may be paid remuneration either by way of a monthly payment or at specified percentage of the net profits of the company, or partly by one way and partly by the other. Except with the approval of the central government, such remuneration shall not exceed 5 percent of the net profits for one such director, or 10 per cent for all of them in case there are more than one such director.

A part time director may be paid remuneration either by way of a monthly, quarterly, or annual payment with the approval of the central government, or by way of commission if the company by special resolution authorises such payment with the approval of the central government, or by a special resolution authorises such payment.

The remuneration paid to part time directors shall not exceed 1 percent of the net profits of the company if the company has a managing or whole time director or a manager and 3 percent of the profits in any other case. However, the company in general meeting may, with the approval of the central government, increase these rates of remuneration.

6.8 MEETING OF DIRECTORS

Directors are the central point of the company. They exercise most of their powers in the board meetings. Sections 285 to 289 of the Companies Act contain provisions regarding the meetings of the directors which are discussed below :

1. According to Section 285, in the case of every company, a meeting of its board of directors shall be held at least once in every three months and at least four such meetings shall be held in every year. However, the central

- government may, by notification in the official gazette, direct that the provisions of this section shall not apply in relation to any class of companies or shall apply in relation thereof subject to such exceptions, modifications or conditions as may be specified in the notification.
2. According to Section 286, notice of every meeting of the board of directors of company shall be given in writing to every director for the time being in India, and at his usual address in India to every other director. Every officer of the company whose duty is to give notice as aforesaid and who fails to do so shall be punishable with fine which may extend to one hundred rupees.
 3. According to Section 287, the quorum for a meeting of the board of directors of a company shall be $\frac{1}{3}$ of its total strength or two directors, whichever is higher.
 4. According to Section 288, if a meeting of the board could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned till the same day in the next week at the same time and place, or if that day is a public holiday, till the next succeeding day which is not a public holiday, at the same time and place.

According to Section 289, no resolution shall be deemed to have been duly passed by the board or by a committee thereof by circulation, unless the resolution has been circulated in draft, together with the necessary papers, if any, to all the directors, or to all the members of the committee, then in India (not being less in number than the quorum fixed for a meeting of the body or committee, as the case may be), and all the other directors or members at their usual address in India, and has been approved by such of the directors as are then in India, or by majority of such of them, as are entitled to vote on the resolution.

6.9 POWERS OF BOARD

A company being an artificial person, acts through its directors. All the powers of management of the affairs of the company are vested in the Board of directors. The Board thus becomes the working organ of the company. In their domain of power, there can be no interference, not even by shareholders. The directors enjoy such powers as are given to them by the Act, memorandum or articles. Sections 291 to 293-A deal with the powers of the Board and the restrictions thereon.

The powers which vest in the Board can be classified under three different heads :

- (1) Powers which can be exercised in accordance with the article.
- (2) Powers which can be exercised only at Board meetings.
- (3) Powers which can be exercised with the consent of shareholders at general meetings.

General Powers : The general powers of the Board of directors are laid down in Section 291 of the Companies Act, 1956. It empowers the Board to exercise all such powers and do all such acts and things, as the company is authorised to exercise and do. In other words, the directors can do what the company is authorised to do unless there is any express restriction on their powers. There are, however, two limitations upon their powers.

1. The Board shall not exercise those powers which under the Companies Act, 1956, or the memorandum of association or otherwise, are required to be exercised by the company in general meeting.
2. The exercising all such powers or doing of any such act, the Board will be subject to provision of this or any other Act, the memorandum or the articles.

Powers to be exercised at the board meeting : According to Section 292, the board of directors of a company shall exercise the following powers on behalf of the company and it shall do so only by means of resolutions passed at the meetings of the board.

- i) The powers to make calls on the shareholders in respect of money unpaid on their shares;
- ii) The power to issue debentures;
- iii) The power to borrow money otherwise than on debentures;
- iv) The power to invest the funds of the company; and
- v) The power to make loans.

However, the board may by a resolution passed at a meeting, delegate to any committee of directors, the secretaries and treasurers, the manager or any other principal officer of the company or in the case of a branch office of the company, a principal officer of the branch office, the powers specified in clauses (iii), (iv) and (v) to the extent specified in this section on such conditions as the board may prescribe.

Powers to be exercised with the consent of the company : Section 293 imposes important restrictions on the powers of the board of directors of public company or any subsidiary of a public company. The following powers can be exercised by the board only with the consent of the company in a general meeting.

- i) Sale or lease of the company's undertakings.
- ii) Extension of the time for the payment of a debt due by a director;
- iii) Investment of compensation received on compulsory acquisition in securities other than the trust securities.

- iv) Borrowing of money beyond the paid-up capital of the company. This, however, does not include temporary loans obtained from the company's bankers in the ordinary course of business.
- v) Contribution to any charitable or other funds beyond fifty thousand rupees in one financial year or 5 percent of the average net profits during the preceding three financial years, whichever is greater.

The consent of a general meeting may be expressed by means of a formal resolution or informally by through conduct.

6.10 MANAGING DIRECTOR

The company may appoint a managing director or manager for the management of the company in addition to the board of directors. However, according to Section 197A, a company can not appoint both a managing director and a manager at the same time.

According to Sec. 2(26) a managing director means a director who, by virtue of an agreement with the company or of a resolution passed by the company in a general meeting or by its board of directors or, by virtue of its Memorandum or Articles of Association, is entrusted with substantial powers of management, which would not otherwise be exercisable by him, and includes a director occupying the position of a managing director, by whatever name called.

However, the power to perform administrative acts of a routine nature when so authorized by the board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of shares or to direct the registration of transfer of shares, shall not be deemed to be included within the substantial powers of management.

It is pertinent to note that the managing director of a company shall exercise his powers subject to the superintendence, control and direction of its board of directors.

Appointment of the Managing Director : The following provisions relate to the appointment of the managing director :

1. Every public company or a private company which is a subsidiary of a public company, having a paid up capital of rupees five crore or more shall have a managing director. This provision was incorporated by the Companies Amendment Act, 1988.
2. No appointment of a person as a managing director in a public company or private company which is a subsidiary of a public company shall be made except with the approval of the central government unless such appointment is made in accordance with the conditions specified in parts (i) and (ii) of Schedule XIII and a return in the prescribed form is filed within 90 days from the date of such appointment.
3. Every application seeking approval to the appointment of a managing director shall be made to the central government within a period of 90 days from the date of such appointment.
4. The central government shall not accord its approval to an application, if it is satisfied that the managing director appointed is, in its opinion, not a fit and proper person to be appointed as such or such appointment is not in public interest or the terms and conditions of the appointment of the managing director are not fair and reasonable.
5. While according approval to an appointment the central government shall be competent to accord approval for a period lesser than the period for which the appointment is proposed to be made .

6. If the appointment of a person as a managing director is not approved by the central government, the person so appointed shall vacate his office as such managing director on the date on which the decision of the central government is communicated to the company, and if he omits or fails to do so, he shall be punishable with a fine which may extend to 500 rupees for every day during which he omits or fails to vacate such office.

Disqualification of the Managing Director : According to Section 267, no company shall after the commencement of this Act, appoint or employ, or continue the appointment or employment of any person as its managing director who :

1. is an undischarged insolvent, or has at any time been adjudged an insolvent.
2. suspends, or has at any time suspended, payment to his creditors, or makes, or has at any time made, a composition with them; or
3. if, or has at any time been convicted by a court of an offence involving moral turpitude.

Number of Managing Directorships : Ordinarily a person can not be the managing director of more than one company. Section 316 restricts the managing directorship to only one company except in the following cases :

1. A public company or a private company subsidiary of public company may appoint a person as its managing director if he is already the managing director or manager of one and not more than one other company including private company which is not a subsidiary of a public company. However, such appointment must have been approved by a board resolution which has been consented to by all the directors present at the meeting. Under this clause, a person can be appointed as the managing director of only two companies and not more.

2. A person can be the managing director of any number of private companies but he can not be the managing director of any public and one private company.
3. The central government may permit any person to be appointed as the managing director of more than two companies if it thinks that the companies should, for their proper working, function as a single unit and have a common managing director.

Terms of office : According to Section 317, no company shall, after the commencement of this Act, appoint or employ any individual as its managing director for a term exceeding five years at a time. Any individual holding, at the commencement of this Act, the office of the managing director in a company shall, unless his term expires earlier, be deemed to have vacated his office immediately on the expiry of five years from the commencement of this Act.

Nothing contained in this section shall be deemed to prohibit the re-appointment, re-employment, or extension of the term of office, of any person by further periods not exceeding five years on each occasion. However, any such re-appointment, reemployment or extension shall not be sanctioned earlier than two years from the date of which it is to come into force. This section does not apply to a private company unless it is a subsidiary of a public company.

6.11 SUMMARY

Since a company is an artificial person having no mind or body of its own it can act only through human agents. These agents are known as directors. The directors occupy a pivotal position in the structure of companies. They are collectively known as a board of directors or board. Every public company other than one which become so by virtue of section 43A of the Act have at least three

directors; and every other company must have at least two directors. Directors may be appointed by the articles, the shareholders, the board of directors, third parties, the principle of proportional representation and the central government. Directors of a company may be removed by the shareholders, by the central government and by company law board. In addition to the board of directors a company may employ managing director for the management of the company.

6.12 KEYWORDS

Director and Board of Directors: Directors are the persons who manage the affairs of the company. They are collectively known as the Board of Directors or Board. If we assume the company to be a body, the directors are its brain. The directors are the elected representatives of the shareholders.

Managing director: According to Sec. 2(26) of Companies Act, 1956, "a managing director means a director who, by virtue of an agreement with the company or of a resolution passed by the company in a general meeting or by its board of directors or, by virtue of its Memorandum or Articles of Association, is entrusted with substantial powers of management, which would not otherwise be exercisable by him, and includes a director occupying the position of a managing director, by whatever name called."

Shareholder and member: The word 'shareholder' is used in relation to a company having a share capital and there can be no membership except through the medium of shareholding. A holder of shares becomes a member only when his name is entered on the register of members. But the term 'member' is wider in scope and may be used in relation to all types of company. A person may become a member of a company without holding any share. Companies limited by guarantee or unlimited companies which may not have share capital, and therefore can have no shareholders but they do have members.

6.13 SELF ASSESSMENT QUESTIONS

1. "Members includes shareholder while shareholder does not include member". Comment.
2. Who may become a member of a company? How to become member of a company ? What are the ways of cessation of membership? Discuss in detail.
3. How and what way are the directors of a company are appointed ?
4. Who are the persons who may not be appointed as directors? Can central government remove their disqualifications?

6.14 REFERENCES/SUGGESTED READINGS

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Lesson No. : 7

MEETINGS AND RESOLUTIONS

STRUCTURE

- 7.0 Objectives
- 7.1 Introduction
- 7.2 Definition of meeting
- 7.3 Statutory meeting
- 7.4 Annual general meeting
- 7.5 Extra ordinary general meeting
- 7.6 Class meeting
- 7.7 Requisites of a valid meeting
- 7.8 Resolution
- 7.9 Summary
- 7.10 Keywords
- 7.11 Self Assessment Questions
- 7.12 References/Suggested Readings

7.0 OBJECTIVES

After reading this lesson, you should be able to understand-

- different kinds of meetings of a company;
- when and how are these meetings held;
- requisites of a meeting to be in order; and
- different types of resolution which may be passed in the meeting.

7.1 INTRODUCTION

The company is an artificial legal person in the eyes of the law having a separate entity distinct from its owners. Being an artificial person, it cannot take decisions on its own. It has to take decision on matters relating to its well

being by way of resolutions passed at properly constituted and conveyed meetings of its shareholders or directors. The decisions about a company's management are taken by the directors in their meetings and they are to be ratified in the general meetings of the company by the shareholders. The first meeting in the life of the company is called the statutory meeting which is convened to inform the members of important facts concerning the promotion of the company as well as its prospects. A general meeting is to be held each year which is called the annual general meeting. It is convened to consider routine matters relating to the appointment of directors and auditors, remuneration of directors, accounts and declaration of dividend. Sometimes, an extraordinary general meeting is also summoned to transact some urgent or special business which cannot be postponed till the next annual general meeting.

7.2 Definition of meeting

There is an old proverb that "two heads are always better than one". When two or more than two persons come together to discuss matters of common interest, there is said to be a meeting. It follows that to constitute a meeting there must be two or more persons. Generally the purpose of a meeting is to consider issues of common interests to its attendants.

The meetings of a company are of two kinds :

1. Meetings of the shareholders
 - i) Statutory meeting
 - ii) Annual general meeting
 - iii) Extra ordinary general meeting
2. Class meetings

7.3 STATUTORY MEETING

Statutory meeting when to be held : Every company limited by shares and every company limited by guarantee and having a share capital shall within a period of not less than one month and not more than six months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company. Such a meeting shall be called the "Statutory meeting" [Section 165(1)]. This is a special kind of meeting and is held only once during the life time of the company. And it is usually the first meeting of the shareholders of a public company.

Object of the holding the statutory meeting : The object of such a meeting is to ensure that at an early date, the members may have an opportunity of ascertaining the precise position and prospect of the company and to discuss matters arising out of the promotion and formation of the company. The main objects of the company, therefore, are :

- (i) to discuss the success of the flotation ; and
- (ii) to approve any modification in the contracts specified in the prospectus, if need arises.

Companies not required to hold a statutory meeting : The following companies are not required to hold a statutory meeting:

- (i) a private company ;
- (ii) an unlimited company;
- (iii) a company limited by guarantee and not having a share capital.

Notice for the meeting: The notice for calling the meeting must be given at least 21 days before the meeting. The notice of convening the statutory meeting must specifically state that the meeting is the statutory meeting. The time, date

and place of the meeting must be mentioned in the notice. If members holding 95% of the paid-up share capital having voting rights consent then, a shorter notice may be sufficient to convene a meeting. Such consent may be before the meeting or after the resolutions were passed.

Statutory report : The board of directors shall, at least twenty one days prior to the date on which the meeting is to be held, forward the statutory report to every member of the company along with the notice of the meeting. The statutory report shall set out :

- a) **Allotment of shares :** The total shares allotted, distinguishing shares allotted as fully or partly paid up, otherwise than in cash. In the case of partly paid up shares, the extent to which they are so paid-up.
- b) **Receipt of cash :** The total amount of cash received by the company in respect of all the shares allotted.
- c) **An abstract of receipts and payments :** An abstract of the receipts and the payments made, upto a date within seven days of the report.
- d) **Directors and auditors:** The names, addresses and occupations of the directors, auditors, manager and secretary and the changes, if any, which have occurred in such names, addresses and occupations, since the date of the incorporation of the company.
- e) **Contracts :**The particulars of any contracts or modification of any contract to be submitted to the meeting for its approval.
- f) **Underwriting contracts :** The extent, to which each underwriting contract, if any, has not been carried out and the reasons therefor.
- g) **Arrears on calls from directors, managers :** The arrears, if any, due on calls from every director and from the manager.

h) **Commission and brokerage :** The particulars of any commission or brokerage paid or to be paid in connection with the issue or sale of shares or debentures to any director or to the manager. [165 (3)]

Certification of statutory report : The statutory report shall be certified as correct by not less than two directors of the company one of whom shall be the managing director.

After certification by the directors, the auditors of the company shall certify the particulars set out regarding the allotment of cash, cash receipts and payments of the company. [165(4)]

A certified copy of the above report shall be delivered to the Registrar for registration. [165(4)].

Procedure at the meeting : A list showing the names, addresses and occupations of the members of the company and the number of shares held by them must be produced by the board of directors at the commencement of the statutory meeting. The list is to remain open and accessible to any member of the company during the continuance of the meeting [165(6)].

Discussion : The members of the company present at the meeting shall be at liberty to discuss any matter relating to the formation of the company or arising out of the statutory report, whether previous notice has been given or not, but no resolution may be passed of which notice has not been given in accordance with the provisions of the Companies Act. [165(7)].

Adjournment of the statutory meeting : The meeting may adjourn from time to time and at any adjourned meeting, any resolution of which notice had been served in accordance with the provisions of the Act, whether before or after the original meeting may be passed and the adjourned meeting shall have the same powers as the original meeting. [165(8)].

Penalty :

If default is made in complying with the provisions of Section 165, every director or other officer of the company who is in default shall be punishable with fine which may extend to five hundred rupees. Failure to hold the statutory meeting or to file the statutory report renders the company liable to be wound up under Section 433.

7.4 ANNUAL GENERAL MEETING

Every company shall in each year hold in addition to any other meeting a general meeting as its annual general meeting [Section 166(1)]. The annual general meeting is to be held in addition to any other general meeting that might have been held in a year. It appears that holding of an annual general meeting in every 'Calendar year' is a statutory necessity. 'Calendar year' is to be calculated from 1st January to 31st December and not twelve months from the date of incorporation of the company.

First annual general meeting : The first annual general meeting must be held within 18 months from the date of incorporation. In that case, the company is not required to hold an annual general meeting in the year of incorporation or in the following year.

Subsequent annual general meeting : Not more than 15 month elapse between the date of one general meeting of the company and that of the next. The Registrar is empowered to extend, for any special reason, the time of holding such as meeting by a period of not exceeding three months.

Power to convene an annual general meeting : The proper authority to convene an annual general meeting is the Board of directors, and if the managing director, manager, secretary or other officer calls a meeting without such authority, it will not be effectual unless the Board ratifies the act before the meeting is held.

Notice for the meeting: A public company must give at least 21 days notice for convening any general meeting including annual general meeting. Annual general meeting may be held with a short notice if it is so agreed by all the members entitled to vote in the meeting (Section 171). The notice shall state the meeting to be an annual general meeting specifically. A private company may also, if the articles so permit, provide for a shorter notice for the annual general meeting.

Date, time and place of holding the annual general meeting : Every annual general meeting shall be called during business hours, on a day that is not a public holiday, and shall be held either at the registered office of the company or at the some other place within the city, town or village in which the registered office of the company is situated. [Section 166 (2)].

The Central Government may exempt any class of companies from these provisions subject to such conditions as it may impose. Public companies and private companies which are subsidiaries of public companies may fix the time their annual general meetings in the articles or by a resolution in the preceding annual general meeting. A private company which is not subsidiary of a public company may, also in a like manner and by resolution agreed to by all the members, fix the time as well as the place for its annual general meeting.

Power of Company Law Board to call annual general meeting : If any company fails to hold an annual general meeting within the prescribed period, the Company Law Board on the application of any member, may either call or direct the calling of a general meeting of the company. It may give such directions as it thinks fit in regard to the calling, holding, or conducting of such meetings. The Company Law Board may direct that one member of the company present in person or by proxy shall be deemed to constitute a meeting. A general meeting held at the directions of the Company Law Board shall be regarded as an annual general meeting. (Section 167).

Penalty : If default is made in holding the meeting of the company in accordance with Section 166 or in complying with any direction of the Company Law Board under Section 167, the company and every other officer of the company who is in default shall be punishable with a fine which may extend to Rs. 5,000 and in the case of continuing default with a further fine which may extend to Rs. 250 for every day during which the default continues. (Section 168).

7.5 EXTRA ORDINARY GENERAL MEETING

Any meeting other than a statutory and annual general meeting shall be called extraordinary general meetings. There are certain matters which can be transacted only by a resolution of members in a general meeting. But it may not be possible to wait until the next annual general meeting for considering such matters. Therefore, the Articles may provide for holding general meetings other than the annual general meeting. These are termed extraordinary general meetings. A general meeting which is held between two consecutive annual general meetings is termed an extraordinary meeting. The Board of Directors of a company shall, on the request of the prescribed number of members of a company shall, proceed to call an extraordinary general meeting of the company.

An extraordinary general meeting may be convened :

1. by the Board of Directors on its own or on the requisition of members; or
2. by the requisitionists themselves on the failure of the Board to call the meeting.
3. by the Company Law Board.

1. Extraordinary meeting convened by the Board of Directors

A) On its own : Regulation 48(1) of Table A provides that the board may,

whenever it thinks fit, call an extraordinary general meeting. An extraordinary general meeting may be convened by the Board of directors if some business of special importance requires the approval of the members and which in the opinion of the Board of Directors can not be postponed till the next annual general meeting. The directors can call an extraordinary general meeting by passing an resolution in a properly convened board meeting.

B) On the requisition of the members : The number of members entitled to requisition a meeting in regard to any matter shall be :

- a) in the case of a company having a share capital, the number holding 10% of the paid up share capital of the company and having a right to vote on the date of deposit of the requisition of the matter to be discussed at the meeting.
- b) in the case of a company not having a share capital, members having 10% of the voting power of all the members having the right to vote on the date of deposit of the requisition on the matter to be discussed.

Matters of requisition : The requisition shall set out the matters of the consideration or which the meeting is to be called, and shall be signed and deposited by the requisitionists at the registered office of the company.

The Board of Directors is under a legal obligation to proceed within 21 days of the deposit of the requisition to call a meeting. The meeting shall be held within 45 days of such deposit of the requisition with the company [Sec. 169 (6)]. On receipt of the requisition, the Board shall send out notices for the meeting giving not less than 21 days time.

2. Extra ordinary meeting convened by the requisitionists

If the Board does not, within 21 days from the date of the deposit of a valid requisition, proceed duly to call a meeting on a day not later than 45 days

from the date of the deposit of the requisition the meeting may be called :

- (a) by the requisitionists themselves.
- (b) in the case of a company having a share capital, by such of them as represent either a majority in value of the paid-up share capital held by all of them or not less than one tenth of the paid up share capital of the company, whichever less; or
- (c) In the case of a company not having a share capital, by such of the requisitionists as represent not less than one tenth of the total voting power of all the members of the company.
- (d) The extraordinary general meeting requisitioned by the members must be within three months of the deposit of the requisition. [Sec. 169 (7)].

The company is bound to repay all reasonable expenses incurred by the requisitionists in calling such a meeting. Any sum so repaid shall be retained by the company out of fees or other remuneration due or likely to become due to directors at fault [Sec. 169 (9)].

3. Extraordinary meeting convened by the Company Law Board

The Company Law Board has been vested with the power to call a meeting of the company. If for any reason it is impracticable to call a meeting of a company, according to the provisions of the Act or the Articles, the Company Law Board may -

- (a) order a meeting of the company to be called, held and conducted in such manner as the Company Law Board thinks fit and
- (b) give such ancillary or consequential directions as the Company Law Board thinks expedient, which may even modify or supplement the provisions of the Companies Act, 1956, and of the company's articles in relation to the calling,

holding and conducting of the meeting. It can also direct that even one member of the company present in person or by proxy shall be deemed to constitute a meeting.

The Company Law Board may do so :

- (a) either on its own motion; or
- (b) on the application of any director of the company, or
- (c) on the application of any member of the company who would be entitled to vote at the meeting.

7.6 CLASS MEETINGS

When it is proposed to alter, vary or affect the rights of a particular class of shareholders (e.g., where accumulated dividends on cumulative preference shares is to be cancelled) and it is not possible to obtain the consent in writing, of the holders of 3/4th of the issued shares of that class, a meeting of the holders of those shares may be called. Such a meeting is commonly known as a 'class meeting'. It should be noted that all resolutions in a class meeting must be passed as special resolutions.

In other words, class meetings are separate meeting of holders of different classes of shares. They are held in cases where their rights are sought to be affected.

7.7 REQUISITES OF A VALID MEETING

A meeting must be called and held in the manner provided in the Act and the articles. Any irregularities in the procedure followed for convening and conducting a meeting will invalidate the proceedings of that meeting. Before a meeting can validly transact any business, the following requirements must be satisfied.

1. Proper Authority

The first essential of a valid meeting is that it must be called by the proper authority. The proper authority is the Board of Directors. A resolution to convene a class meeting must be passed in a Board meeting. In case of default by the directors, the requisitionists or the Company Law Board may call the meeting. When a meeting is called by the Managing Director, Manager, Secretary or some other officer without proper authority, it will not be effected without ratification by the Board before the meeting is held. Where the Board's meeting was held by certain directors by preventing some lawfully constituted directors from attending the meeting but the quorum was however present, the meeting was held to be unlawful and the notice convening the general meeting also became invalid. (Harben V. Phillip).

2. Notice

The second requirement of a valid meeting is that all those who are concerned with business of the meeting and are entitled to attend it, are communicated of the date, time and business of the meeting. Such a communication is called 'notice of the meeting'.

Length of notice : Not less than 21 days notice in writing should be given to the members to call a meeting of any kind. Not less than 21 days mean that both the date of the meeting and the date on which it is served are to be excluded i.e. 21 days notice.

Where the notice is sent by post, it shall be deemed to have been received at the expiration of forty eight hours after the posting. In nutshell, the gap should be of twenty one clear and whole days.

Example : Notice were posted on October 16 for a meeting to be held on November 7. Notice was held to be short by one day because in counting the 21 days the date of posting and the date on which the meeting is to be held will be excluded. [N.V.R. Nagappa Chettiar v. The Madras Race Club. (1949) 1 MLJ 662].

The requirement of 21 days notice of the meeting overrides any provision in the articles for a shorter period. But the articles can validly provide for longer notice than the statutory minimum period.

When shorter notice will be sufficient : The meeting can however, be called by giving a shorter notice in the following cases :

- (a) In the case of annual general meeting, by the consent of all the members entitled to attend and vote.
- (b) In the case of any other meeting, by the consent of the members holding not less than 95 per cent paid up share capital of the company, or holding not less than 95 per cent of the total voting power of the company (when a company does not have a share capital).

Notice to whom : Notice of every meeting must be given to the following persons

- (i) Every member of the company.
- (ii) Every person entitled to share in consequence of the death or insolvency of a member.
- (iii) The auditor or auditors of the company. [Sec. 172].
- (iv) The public trustees. [Sec. 187B (1)].

If share is held jointly by more than one person, notice may be served on the joint holder named first in the register in respect of the share [Sec. 54 (4)]. When the heirs of a deceased member do not give their addresses, a notice served on the address of the deceased member will serve the purpose.

Where notice of the meeting is given by advertisement in a newspaper circulating in the neighbourhood of the registered office of the company under Section 53(3) of the Act, explanatory statement need not be annexed to the notice under Section 173 of the Act. But it is necessary to mention in the advertisement that the explanatory statement has been forwarded to the members of the company.

Omission to give notice : Deliberate omission to give notice of the meeting to the members or to a single member will make the meeting invalid. But an accidental omission to give notice to or non-receipt of the notice by any member shall not invalidate the proceedings at the meeting.

Notice in case of a adjourned meeting : An adjourned meeting is a continuation of the original meeting and therefore, a fresh notice of such a meeting is not required to be given to the members unless articles so provide.

If the meeting is adjourned *sine die* (i.e. without fixing a day for the holding of adjourned meeting) or if fresh business, other than such business as is left uncompleted at the original meeting, is to be discussed, a fresh notice of the adjourned meeting must be given. Also, Regulation 53 of Table A provides, "when a meeting is adjourned for 30 days or more, notice of adjourned meeting shall be given as in the case of original meeting."

Contents of the notice : Every notice of a company must specify the place, day and hour of the meeting and shall contain a statement of the business to be transacted thereat. If time for holding the meeting and other essential particulars required by the Section 172 are not mentioned in the notice, the meeting will be invalid and all resolutions passed thereat will be of no effect.

(a) Ordinary and special business : Notice of meeting must contain a statement of nature of the business to be transacted in the meeting. Section 173 classifies the business into ordinary business and special business.

Ordinary business : The followings business which is transacted at every annual general meeting is considered as ordinary business.

- (i) The consideration of accounts, balance sheet and the report of the Board of directors and auditors.
- (ii) The declaration of a dividend.
- (iii) The appointment of directors in place of those retiring.
- (iv) The appointment of and fixing the remuneration of auditors.

(b) **Special business :** Any business other than ordinary business transacted at an annual general meeting and all business transacted at the statutory meeting and at any extraordinary general meeting is deemed as special business.

3. Quorum

A quorum may be defined as the minimum number of members who must be present at a meeting in order that the business of the meeting may be validly transacted. Unless the articles of the company provide for a large number, five members personally present in the case of public companies (other than a public company which has become such as virtue of Section 43-A) and two persons personally present in the case of private company will be the quorum for a meeting of the company. It may be noted that the articles cannot provide for a smaller quorum. No proxy is counted in-forming the quorum. However, a representative of a corporation is treated as a member for personally present and not as a proxy. Also, joint-holders are treated as one member for purposes of quorum.

Consequences of absence of quorum : If within half an hour from the time fixed for the meeting, the quorum is not present, the meeting shall stand dissolved if it was called at the requisition of the members. [Sec. 174 (3)]. In any other case, the

meeting shall stand adjourned to the same day next week, at the same time and place [Sec. 174 (4)]. If at the adjourned meeting also, the quorum is not present within half an hour, the members present shall be the quorum. [Sec. 174(5)].

Where no quorum is present, the meeting is not legally constituted and the business transacted at the meeting or any resolution passed at the meeting becomes invalid.

One man meeting : Where only one person is present, he cannot form a quorum, as a single member cannot constitute a meeting. However, the Company Law recognises certain exceptions which are as follows :

- (i) One member may constitute a quorum for a meeting where he holds all the shares of a class. This, where all the preference shares in a company were held by one shareholder only it was held that a meeting of the preference shareholder attended by him only was valid.
- (ii) One member may constitute a quorum for an annual general meeting when it is called by the Company Law Board under Section 167 of the Act.
- (iii) One member of the company present in proxy or by person, shall be deemed to constitute a meeting where the Company Law Board orders a meeting of the company to be held under Section 186.
- (iv) Where a quorum is not present at a general meeting within half an hour of the meeting, the meeting shall stand adjourned to the same day in the next week at the same time and place. If at the adjourned meeting also a quorum is not present within half an hour of the time of the meeting, the members present are the quorum. In such a case even one member will constitute the quorum.

4. Chairman

A chairman is necessary for the proper conduct of the meeting. Normally, the articles of association provide for the manner in which the chairman will be appointed. If the articles are silent then provisions of Sec. 176 shall apply which are as under :

- (a) Unless the articles of the company otherwise provide, the members personally present at the meeting shall elect one of themselves to be the chairman thereof by a show of hands.
- (b) If a poll is demanded on the election of a chairman, it shall be taken forthwith in accordance with the provisions of the Act. The chairman elected by a show of hands shall exercise all the powers of the chairman for such poll.
- (c) If some other person is elected chairman as a result of the poll, he shall be the chairman for the rest of the meeting. The court is also empowered to appoint an independent chairman to preside over the meetings in certain circumstances e.g. when there are groups among the shareholders and a peaceful meeting under the chairmanship of a person appointed by either group is impossible. (*Selvaraj V. Mylapore H.P. Fund (1968) 1 comp LJ 93 Mad.*)

Duties of the Chairman

- 1. He must take care that the minority is not oppressed in any way.
- 2. He must give the members who are present a reasonable opportunity to discuss any proposed resolution and it must be ensured that all the views are adequately aired. But at the expiry of a reasonable time, if he thinks fit, he should stop the discussion on any resolution .

3. He must see that the meeting is properly convened and constituted i.e . proper notice was given to every person entitled to attend the meeting and his own appointment is in order. It is the chairman who is to see whether a quorum is present before proceeding with the business.
4. The chairman must conduct the proceedings in accordance with the provisions of the Act, the companies articles of association or Table A or in the absence thereof, the common law relating to the meetings.
5. He should adjourn the meeting when it is impossible, by reason of disorder or other like cause, to conduct the meeting and complete its business. He must not use this power in a malafide manner.
6. He must keep order in the meeting. He must decide all questions which arise at the meeting and which require decision at the time.
7. He should exercise his casting vote, if any, provided by the articles for the benefit of the company.
8. The minutes of the meeting should be properly recorded and signed by the chairman.

5. Minutes of the meeting

The term 'minutes' means the official recording of the business transacted at the meeting. Every company has to keep a record of all the proceedings of :

- a) every general meeting, or
- b) every meeting of its Board of Directors or
- c) every committee of the Board.

Entries of the proceedings must be made in the minute book within 30 days of the closing of the meeting concerned. The minute book cannot be a loose leaf binder and the proceedings cannot be type written. Pages of the minute book must be consecutively numbered . Each page of every book shall be signed and the last page of the record of the proceedings of each meeting in such book shall be dated and signed by

- a) in the case of the minutes of the proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;
- b) in the case of the minutes of the proceedings of a general meeting, by the chairman of the same meeting within a period of 30 days or in the event of the death or inability of that chairman to sign within that period, by a director duly authorised by the Board for that purpose [193 (1-A)].

Contents of the minutes : The minutes of each meeting shall contain fair and correct summary of the proceedings of the meeting. All appointments of officers made at any of the meetings shall be included in the minutes of the meeting. In the case of a meeting of the Board of Directors or of a committee of the Board, the minutes shall also contain the names of the directors present at the meeting; the names of the directors, if any, dissenting from or not concurring with the resolution.

Penalty : If default is made in complying with the provision of Sec. 193, in respect of any meeting, the company and every officer of the company who is in default shall be punishable with fine which may extend to 50 rupees.

7.8 RESOLUTIONS

Most matters, which generally come up for consideration at the general meeting of the company, are presented in the form of motions recommending that the meeting may express approval or disapproval or take certain action or order some thing to be done. A motion is a proposal which may be made by the chairman or any member of the company. Resolution is the adoption of a motion duly made and seconded. A motion is put to the meeting and is open to discussion. After the discussion, the chairman puts it to vote either by show of hands or by poll. After the counting of votes, the final result is declared. Thus the decisions of a company are made in the form of resolutions by a majority of the members present and voting at the general meeting which is conducted in accordance with the provisions of the articles and the Act.

Kinds of resolutions

Three kinds of resolutions are recognised by the Companies Act 1956:

1. Ordinary resolutions
2. Special resolutions
3. Resolutions requiring special notice.

1. **Ordinary resolution [Sec. 189 (1)]** : A resolution shall be ordinary, when for its adoption, the votes required to be cast in favour of the resolution exceed the votes cast against the resolution including the casting vote if any, of the chairman. The members can cast votes in person or by proxy where proxies are allowed. Voting can be done either by show of hands or by a poll. An ordinary resolution means a resolution passed by simple majority of the share holders present and voting.

An ordinary resolution is enough to carry out and matter unless the Companies Act or memorandum or articles provide otherwise i.e. they require a special resolution or resolution requiring a special notice for the passing of a matter.

Transactions where ordinary resolution is required : The matters for which an ordinary resolution is enough are as follows :

1. Issue of shares at discount (Sec. 79)
2. Alteration of the share capital (Sec. 94)
3. Approval of the statutory report (Sec. 165)
4. The consideration of accounts, the Balance Sheet and the report of the Board of Directors and of the auditors (Sec. 210)
5. Appointment of auditors and fixation of their remuneration (Sec. 224 (1))
6. Appointment of the first directors who are to retire by rotation (Sec. 255 (1))
7. Increase or decrease in the number of directors within the limits prescribed by the Articles (Sec. 258)
8. Adoption of the appointment of sole selling agents (Sec. 294)
9. Removal of a director and appointment of another director in his place [Sec. 284 (1)]
10. Declaration of dividend [Sec. 205]
11. Appointment of liquidator in case of voluntary winding up and fixing his remuneration [Sec. 490 (1)]
12. To rectify the name of the Company [Sec. 22]
13. To cancel or redeem debentures [Sec. 21]
14. To appoint director by rotation [Sec. 256]
15. To approve the remuneration of directors [Sec. 309]
16. To fill the vacancy in the office of Liquidator [Sec. 492]

Special resolution [Sec. 189 (2)] : A resolution shall be a special resolution when.

- a) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting ;
- b) the notice required under the Act has been duly given of the general meeting;
and
- (c) the votes cast in favour of the resolution (whether on a show of hands or on a poll) by members are not less than three times the number of votes, if any, cast against the resolution by members. Members can vote personally or by proxy.

Transactions where a special resolution is required : In addition to the matters given in the articles of the company, the Companies Act specifies certain matters for which a special resolution must be passed. For example,

1. To alter the memorandum of the company (Sec. 17)
2. Alteration in the Articles of the company [Sec. 31].
3. To offer further shares without the pre-emptive right [Sec. 81]
4. To reduce the share capital [Sec. 100]
5. For creation of a reserve capital (Sec. 99)
6. To pay interest out of the capital [Sec. 208]
7. For the approval of the variation of the share holders' rights [Sec. 106]
8. To request the central government to appoint inspectors for investigating the affairs in certain cases [Sec. 237].
9. To make the liability of the managerial personnel unlimited [Sec. 323].

10. To appoint sole selling or buying agents in the case of companies having a paid up share capital of rupees fifty lakh or more [Sec. 294-AA]
11. To apply to a court for the winding up of the company [Sec. 433(a)]
12. To wind up the company voluntarily [Sec. 484].
13. To authorise inter company loans.

Resolutions requiring a special notice [Sec. 190] : Where special notice of any resolution is required by the Companies Act or the articles of the company, notice of the intention to move the resolution shall be given to the company at least fourteen days before the meeting at which it is to be moved. It will be exclusive of the day on which the notice is served or deemed to be served and the day of the meeting.

The company shall, immediately after the notice of the intention to move any such resolution has been received by it, give its members notice of the resolution in the same manner as it gives notice of the meeting. If that is not practicable, the company shall give notice thereof, either by advertisement in a newspaper having an appropriate circulation or in any other mode allowed by the articles, not less than seven days before the meeting. The object of drawing special attention of the company, and through the company of the members, is to give the members sufficient time to consider the proposed resolution and to give an opportunity to the directors to indicate their views if the resolution is proposed by the share holders.

Transactions where special notice is required

1. Appointment of an auditor other than the retiring auditor [Sec. 225]
2. To provide for an express resolution that the retiring auditor shall not be reappointed [Sec.. 225]

3. Resolution to remove a director before the expiry of his term [Sec. 284]
4. To appoint another person as director in place of the one removed [Sec. 284]

The company may specify additional matters for which special notice is required.

7.9 SUMMARY

The meetings of a company are of two types namely shareholders meeting and class meeting. The meeting of the shareholders can be of three types namely statutory meeting, an annual general meeting and an extraordinary general meeting. Statutory meeting is the first meeting of the shareholders of a public company held once in the life time of a company. The object of holding such meeting is to furnish the shareholders with full information of the result of the formation of the company and an opportunity of discussing these result before the company has embarked on trading to any appreciable extent. Every company, must in each year hold, in addition to any other meeting, a general meeting as its annual general meeting. Any meeting other than a statutory and an annual general meeting is called an extraordinary general meeting. Such meeting is held to transit any urgent or special business which cannot be postponed to the next annual general meeting. Class meetings are separate meeting of holders of different classes of shares. They are held in cases where their rights are sought to be affected. At a general meeting, of which notice has been given, if votes cast in favour of the resolution by members exceed the vote, if any, cast against the resolution, the resolution so passed is an ordinary resolution. If the votes cast in favour of the resolution by members are three times the number of the votes, if any, cast against the resolution, the resolution so passed is a special resolution. The Companies

Act also provides specific cases in which special notice of resolutions proposed to be moved at the meeting of the company required is to be given to the company.

7.10 KEYWORDS

Annual general meeting: Every company shall in each year hold in addition to any other meeting a general meeting as its annual general meeting [Section 166(1)]. The annual general meeting is to be held in addition to any other general meeting that might have been held in a year. It appears that holding of an annual general meeting in every 'Calendar year' is a statutory necessity. 'Calendar year' is to be calculated from 1st January to 31st December and not twelve months from the date of incorporation of the company.

Class meeting: When it is proposed to alter, vary or affect the rights of a particular class of shareholders (e.g., where accumulated dividends on cumulative preference shares is to be cancelled) and it is not possible to obtain the consent in writing, of the holders of 3/4th of the issued shares of that class, a meeting of the holders of those shares may be called. Such a meeting is commonly known as a 'class meeting'. It should be noted that all resolutions in a class meeting must be passed as special resolutions.

Meeting: When two or more than two persons come together to discuss matters of common interest, there is said to be a meeting.

Minutes: It means the official recording of the business transacted at the meeting.

Ordinary resolution: According to Section 189 (1) of Companies Act, 1956, "A resolution shall be ordinary when for its adoption the votes required to be cast in favour of the resolution exceed the votes cast against the resolution including the casting vote, if any, of the chairman.

Statutory meeting: Every company limited by shares and every company limited by guarantee and having a share capital shall within a period of not less than one month and not more than six months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company. Such a meeting shall be called the "Statutory meeting" [Section 165(1)]. This is a special kind of meeting and is held only once during the life time of the company.

Quorum: A quorum may be defined as the minimum number of members who must be present at a meeting in order that the business of the meeting may be validly transacted.

7.11 SELF ASSESSMENT QUESTIONS

1. What are the different kinds of meetings of a company ? When and how are these meetings held ?
2. What is a statutory meeting? When and how is it held? What are the object of such a meeting?
3. Discuss the statutory provisions regarding the holding of an annual general meeting.
4. Explain the various types of resolutions which may be passed in the meeting of shareholder.
5. What are the requisites of a valid meeting? Discuss in detail.

7.12 REFERENCES/SUGGESTED READINGS

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Lesson No. : 8

WINDING UP PROCESS

STRUCTURE

- 8.0 Objectives
- 8.1 Introduction
- 8.2 Modes of winding up
- 8.3 Compulsory winding up
- 8.4 Voluntary winding up
- 8.5 Voluntary winding up subject to the supervision of court
- 8.6 Consequences of winding up
- 8.7 Summary
- 8.8 Keywords
- 8.9 Self Assessment Questions
- 8.10 References/Suggested Readings

8.0 OBJECTIVES

After reading this lesson, you should be able to understand-

- Grounds for compulsory winding up and who can make petition for it;
- Basis for voluntary winding up and consequences of voluntary winding up;
- Advantages of winding up subject to the supervision of court; and
- Consequences of winding up.

8.1 INTRODUCTION

Winding up of a company is a process of putting an end to the life of a company. It is a proceeding by means of which a company is dissolved and in the course of such a dissolution its assets are collected, its debts are paid off out of

the assets of the company or from contributions by its members, if necessary. If any surplus is left, it is distributed among the members in accordance with their rights. During the process of winding up, the company still exists and has corporate powers until dissolution. Till dissolution the property of the company remains vested in the name of company.

8.2 MODES OF WINDING UP

A company can be wound up in three ways :

1. Compulsory winding up by the court
2. Voluntary winding up : (i) Members' voluntary winding up ; (ii) Creditors' voluntary winding up;
3. Voluntary winding up subject to the supervision of the court.

8.3 COMPULSORY WINDING UP OR WINDING UP BY COURT

Winding up by the court, also called compulsory winding up, may be ordered in cases mentioned in Sec. 433. The court will make an order for winding up on an application by any of the persons enumerated in Sec. 439.

8.3.1 Grounds For Compulsory Winding up (Sec. 433)

1. *Special resolution of the company* [Sec. 433 (a)] : If the company has by a special resolution resolved that it may be wound up by the court, the court may pass a winding up orders. The power of the court in such a case is discretionary and should be exercised only where a bona fide case is made out. The court may refuse to order winding up where it is opposed to public or company's interest.
2. *Default in holding statutory meeting* [Sec. 433(b)] : If a company makes default in delivering the statutory report to the registrar or in holding the statutory

meeting, the court may order winding up of the company either on the petition of the registrar or on the petition of the contributory. The petition for winding up must not be filed before the expiration of 14 days after the last day on which the statutory meeting ought to have been held.

However, the court may instead of taking a winding up order, direct that the statutory report shall be delivered or that a meeting shall be held. If the company fails to comply with the order then the court will wind up the company.

3. *Non-commencement or suspension of business* [Sec. 433 (c)] : Where a company does not commence its business within a year from its incorporation, or suspends its business for a whole year, the court may order for its winding up. The power of the court is discretionary and will be exercised only where there is fair indication that the company has no intention to carry on the business. Where the suspension of the business is temporary or can be satisfactorily accounted for, the court will refuse to make an order. No order of winding up will be made if the company satisfies the court that the business of the company has been temporarily suspended on account of some difficulties to carry it on, and that it has intention to resume that business when it can be carried on profitably.

A company will not be wound up if it abandons one of its several businesses, unless that business is the main object of the company. Even if the work of all the business has been suspended, even then it will still be open to the court to examine whether it will be possible for the company to continue its business.

4. *Reduction of members below minimum* [Sec. 433 (d)] : Where the number of members is reduced below 7 in the case of a public company and below 2 in

case of a private company, the court may order the winding up of company. The ground for winding up is meant to enable members to escape personal liability for the company's debts which he incur under Section 45 of the Act.

5. *Inability to pay debts.* [Sec. 433 (e)]. The court may order for the winding up of a company if it is unable to pay its debts. According to Section 434 of the Act a company shall be deemed to be unable to pay its debts in the following cases :

(a) **Statutory Notice** : If a creditor to whom the company owes a sum of Rs. 500 or more has served on the company a notice for payment and the company has for three weeks neglected to pay or otherwise satisfy him. But where the company bona fide disputes regarding the debts, and the court is satisfied with the defence of the company, the court will not order for its winding up.

(b) **Decreed debt** : If execution or other process issued on a decree or order of any court in favour of a creditor is returned unsatisfied in whole or in part.

(c) **Commercial Insolvency** : If it is proved to the satisfaction of the court that the company is unable to pay its debts and in determining whether a company is unable to pay its debts, the court will take into account the contingent and the prospective liabilities of the company. If a company is unable to meet its current liabilities, it is commercially insolvent and liable to be wound up.

Where there is a bona fide counter claim put forward by the company, it will be a valid excuse for non-payment, and inability to pay will not be inferred.

6. *Just and equitable* [Sec. 433(f)] : The last ground on which the court can order the winding up of a company is when the court is of the opinion that it is just and equitable that the company should be wound up. This clause gives the

court a very wide power to order winding up wherever the court considers it just and equitable to do. The court will consider such grounds to wind up a company for just and equitable reasons as are not covered by the preceding five clauses. What is just and equitable will depend upon the facts of each particular case. The court while winding up a company under this clause will have to take into consideration not only the interests the share holders and creditors but also public interest in the shape of needs of community, interests of the employees etc.

Following are the instances where the courts have dissolved the companies under the just and equitable clause :

- (i) Loss of substratum.
- (ii) Deadlock in management.
- (iii) Oppression of minority.
- (iv) Fraudulent purpose.
- (v) Incorporated or quasi partnership.
- (vi) Where the company is a bubble and has no business to carry on, it was wound up.
- (vii) Where the company was insolvent and was being carried on for the benefit of the debentureholders, who had taken possession, a winding up order was made.

8.3.2 Who may Petition? (Sec. 439)

The following persons can make a petition to the court to get an order for the winding up of a company :

1. Petition by Company : A company can make a petition only when it has passed a special resolution to that effect. However, it has been held that where the company is found by the directors to be insolvent due to circumstances which ought to be investigated by the court, the directors may apply to the court for an order of winding up of the company even without obtaining the sanction of the general meeting of the company.

2. Petition by Creditors : The word 'creditor' includes secured creditor, debenture-holder and a trustee for debenture-holder. A contingent or prospective creditor (such as the holder of a bill of exchange not yet matured or of debentures not yet payable) is also entitled to petition for a winding up of the company.

Before a petition for winding up of company presented by a contingent or prospective creditors is admitted, the leave of the court must be obtained for the admission of the petition. Such leave is not granted (a) unless, in the opinion of the court, there is a prima facie case for winding up the company; and (b) until reasonable security for costs has been given.

Notice that a creditor has a right to a winding up order if he can prove that he claims an undisputed debt and that the company has failed to discharge it. When a creditor's petition is opposed by other creditors, the court may ascertain the wishes of the majority of creditors.

3. Contributory Petition : The term 'contributory' means every person who is liable to contribute to the assets of the company in the event of its being wound up. Section 428 makes it clear that it includes the holder of fully paid shares. A fully paid shareholder will not, however, be placed on the list of contributories, as he is not liable to pay any contribution to the assets, except in cases where surplus assets are likely to be available for distribution.

A contributory is entitled to present a petition for winding up a company if :

- (a) the number is reduced, in the case of a public company below seven and in the case of a private company below two; and
- (b) The shares in respect of which he is a contributory either were originally allotted to him or have been held by him; and
- (c) the shares have been registered in his name, for at least six months during the period of 18 months immediately before the commencement of the winding up; and
- (d) the shares have been devolved on him during the death of a former holder [Sec. 439 (4)].

4. Joint Petition : The company, its creditor and/or any contributory may also present a petition for the winding up of the company jointly.

5. Registrar's Petition : The registrar present a petition for winding up a company only on the following grounds, viz.,

- (a) if a default is made in delivering the statutory report to the Registrar or in holding the statutory meeting;
- (b) if the company does not commence its business within a year from its incorporation, or suspends its business for a whole year;
- (c) if the number of members is reduced, in the case of a public company below seven and in the case of a private company below two ;
- (d) if the company is unable to pay its debts; and

- (e) if the court is of opinion that it is just and equitable that the company should be wound up.

Note that the Registrar can file a petition for winding up only with prior approval of the Central Government. The Central Government before sanctioning approval must afford an opportunity to the company for making its representations, if any.

6. Petition by any Person Authorised by the Central Government (Sec. 439 (1)) If it appears to the central Government from any report of the inspectors appointed to investigate the affairs of the company, that it is expedient to wind up the company because its business is being conducted with intent to defraud creditors, members or any other person, or its business is being conducted for a fraudulent or unlawful purpose, or the management is guilty of fraud, misfeasance or other misconduct, the Central Government may authorise any person to present to the court a petition for a winding up of the company that it is just and equitable that the company should be wound up.

8.3.3 Commencement of Winding up [Section 441]

The winding up of a company by the court shall be deemed to commence at the time of the presentation of the petition for the winding up. If no order for winding up is made and the winding up petition is dismissed, the date of presentation of the winding up petition has no relevance. As such, until winding up order is made, the company will have to comply with the requirements of the Companies Act as are required of company not wound up. Also the words 'shall be deemed to commence' indicate that although the winding up of a company does not in fact commence at the time of the presentation of the petition, it nevertheless shall be taken to commence from that time if and when the winding -up order is

made. However, where before the presentation of a petition for the winding up of a company by the Court, a resolution has been passed by the company for voluntary winding up, the winding up of the company is deemed to have commenced at the time of the passing of the resolution.

8.3.4 Consequence of Winding up Order

The consequences of the winding up order by the Court are as follows :

1. The court must, as soon as the winding up order is made, cause intimation thereof to be sent to the official liquidator and the Registrar [Section 444].
2. The petitioner and the company must also file with the Registrar within 30 days a certified copy of the order [Section 445(1)]. The Registrar should file with himself a certified copy of the winding up order of the Court when he himself is a petitioner under Section 439. If default is made in filing the certified copy of the order, the petitioner, or the company and every officer of the company who is in default, shall be punishable with fine upto Rs. 100 for every day during which the default continues [Section 445].
3. The Registrar should then make a minute of the order in his books relating to the company and notify in the Official Gazette that such an order has been made [Section 445(2)].
4. The order for winding up is deemed to be a notice of discharge to the officers and employees of the company, except when the business of the company is continued [Section 445 (3)].
5. The order operates in the interests of all the creditors and all the contributories, no matter who in fact asked for it [Section 447].

6. The Official Liquidator, by virtue of his office becomes the liquidator of the company and takes possession and control of the assets of the company [Section 449].
7. All actions and suits against the company are stayed, unless the Court gives leave to continue or commence proceedings [Section 446].
8. Any suit or proceeding pending in any other court shall be transferred to the Court in which the winding up of the company is proceeding [Section 446 (3)].
9. All the power of the Board of directors cease and the same are then exercised by the liquidator [Section 491 & 505].
10. On the commencement of winding up, the limitation ceases to run in favour of the company.
11. Any disposition of the property of the company, and any transfer of shares in the company or alteration in the status of members made after the commencement of winding up shall, unless the Court otherwise orders, be void [Section 563 (2)].
12. Any attachment, distress or execution put in force, without leave of the court, against the estate or effects of the company after the commencement of the winding up shall be void [Section 537 (a)] but not for dues payable to Government [Section 537 (2)].
13. Any sale held, without leave of the court, of any of the properties or effects of the company after the commencement of the winding up shall be void [Section 537 (a)] but not for dues payable to Government [Section 537 (2)].

14. Any floating charge created within 12 months preceding the commencement of winding up is void unless it is proved that the company after the creation of the charge was solvent, except as to, any cash advanced at the time of or subsequent to the creation of the charge or to any interest on that amount @ 5% or such other rate notified by the Central Government [Section 534].

Statement of Affairs to be Made to the Liquidator [Section 454] : When a winding up order is made by the Court, the directors of the company must make to the liquidator a statement as to the affairs of the company, stating the following particulars :

1. The debts and liabilities of the company.
2. The assets of the company, showing separately the cash in hand and in bank, if any.
3. The name, residence and occupation of each creditor stating separately the amount of secured debts and unsecured debts.
4. The debts due to the company, and the name, residence and occupation of each person from whom the sum is due and the amount likely to be realised therefrom.

The object of such a statement is to give the liquidator an idea as to the financial affairs and liabilities of the company. The creditors and contributories of the company can inspect the statement. The statement should be made within 21 days (or such extended time not exceeding 3 months as the official liquidator or Court may for special reasons allow) after the relevant date. The relevant date is the date of the winding up order by the Court or where provisional liquidator is appointed, the date of his appointment. The statement must be submitted and

verified by affidavit by one or more persons who, at the relevant date are the Directors, and by the person who at that time is the Manager, Secretary or other Chief officer of the company. Defaulter shall be punishable with imprisonment upto 2 years or with fine upto Rs. 100 for every day during which default continues or with both.

Committee of Inspection : The Court may, at the time of making an order of winding up of a company or at any time thereafter, direct that there shall be appointed a committee of inspection to act with the liquidator. In such a case the liquidator must, within 2 months from the date of such direction convene a meeting of the creditors of the company for the purpose of determining who are to be members of the committee. Within 14 days from the date of the creditors meeting (or such further time as the Court in its direction may grant for the purpose), the liquidator should convene a meeting of the contributories to consider the decision of the creditors' meeting with respect to the membership of the committee. It is open to the meeting of the contributories to accept the decision of the creditor's meeting with or without modifications or to reject it. The liquidator must apply to the Court for directions as to what the composition of the committee shall be and who shall be members thereof. However, it will not be unnecessary to seek directions in this regard where the meeting of the contributories accepts the decision of the creditors' meeting in its entirety.

8.4 VOLUNTARY WINDING UP

Winding up by the creditors or members without any intervention of the Court is called 'voluntary winding up'. In voluntary winding up, the company and its creditors are left free to settle their affairs without going to the Court, although they may apply to the Court for directions or orders if and when

unnecessary. Winding up should not be confused with insolvency. Company may be solvent and running a prosperous business yet it may decide to be wound up voluntarily, e.g., in pursuance of a scheme of reconstruction or amalgamation.

A company may be wound up voluntarily :

1. If the company in general meeting passes an ordinary resolution for voluntary winding up where the period fixed by the articles for the duration of the company has expired or the event has occurred on which under the articles the company is to be dissolved.
2. If the company resolves by special resolution that it shall be wound-up voluntarily [Section 484].

When a company has passed a resolution for voluntary winding up, it must, within 14 days of the passing of the resolution, give notice of the resolution by advertisement in Official Gazette and also in some newspaper circulating in the district where the registered office of the company is situated. In case of default, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 50 for every day during which the default continues [Section 485].

8.4.1 Consequences of Voluntary Winding up

The consequences of voluntary winding up are as follows :

1. A voluntary winding up is deemed to commence at the time when the resolution for voluntary winding up is passed (Section 486). This will be so even when after passing a resolution for voluntary winding up, a petition is presented for winding up by the Court (Section 441).

2. The company, from the commencement of winding up, must cease to carry on its business except so far as may be required to secure a beneficial winding up although the corporate state and powers of the company continue until final dissolution (Section 487).
3. All transfers of shares and alterations in the status of members, made after the commencement, are void unless sanctioned by the liquidator (Section 536).
4. A resolution to wind up voluntarily operates as notice of discharge to the employees of the company (*Fowler v. Commercial timber Co.*) except :
 - (a) when the liquidation is only with a view to 'reconstruction' (*Midland Countries Bank Ltd. v. Attwood* (1905) 1 Cg. 357) or
 - (b) when business is continued by the liquidator for the beneficial winding up of the company.
5. On the appointment of the liquidator, all the powers of the board of directors, managing director or manger shall cease except (Section 491) :
 - (a) for the purpose of giving notice to the Registrar about the name of the liquidator appointed, or
 - (b) in so far as the company in general meeting or the liquidator may sanction the continuance of their powers.

8.4.2 Kinds of voluntary winding up

Voluntary winding up may be :

- (a) A member's voluntary winding up;
- (b) A creditors' voluntary winding up.

Members' Voluntary Winding up : The procedure for a member's voluntary winding up is as follows :

Declaration of Solvency : In the case of members' voluntary winding up, a declaration of the company's solvency has to be made. Section 488 provides that where it is proposed to wind up a company voluntarily, its directors or in case the company has more than two directors, the majority of the directors may, at a meeting of the board, make a declaration (declaration of solvency) verified by an affidavit to the effect that they have made a full inquiry into the affairs of the company and they are of opinion that the company has no debts or that it will be able to pay its debts in full within such period not exceeding three years from the commencement of the winding up as may be specified in the declaration. The declaration will be effective only if it is made within five weeks immediately preceding the date of the passing of the resolution for winding up and is delivered to the Registrar before that date ; and is accompanied by a copy of the report of the auditors of the company on the profit and loss account of the company for the period commencing from the date upto which the last such account was prepared and ending the latest practicable date immediately before the making of the declaration and the balance sheet of the company made out as on the last-mentioned date and also embodies a statement of the company's assets and liabilities as at that date. Any director making a false or reckless declaration will be punishable with imprisonment upto six months, or with fine up to Rs. 5,000 or with both.

Provisions Application to Members' Voluntary Winding up : The important provisions are :

1. *Appointment and Remuneration of Liquidator :* On the passing of the resolution for winding up, the company must in a general meeting appoint one or

more liquidators and fix his or their remuneration. Any such remuneration cannot be increased at all, not even with the sanction of the court and the liquidator cannot take charge of his office unless the remuneration is so fixed (Sec. 490).

2. *Powers of the Board on Appointment of Liquidator* : On the appointment of a liquidator, all the powers of the board and of a managing or whole-time director, and manager, shall cease, except for the purpose of giving notice of such appointment to the Registrar or in so far as the company in a general meeting or the liquidator may sanction the continuance thereof (Sec. 491).

3. *Office of the Liquidator Falling Vacant* : If a vacancy occurs by death, resignation or otherwise in the office of any liquidator appointed by the company, the company in a general meeting may fill the vacancy (Sec. 492).

4. *Notice of Appointment to Registrar* : The company must, within 10 days of the appointment of the liquidator, or the filling of the vacancy, as the case may be, give notice of the vacancy, as the case may be, give notice to the Registrar of the event. Default renders the company and every officer (or liquidator) who is in default liable to fine upto Rs. 100 for every day of default (Sec. 493).

5. *Disposal of Property* : The liquidator may, with the sanction of a special resolution of the company, sell all or part of the company's business or property for shares or like interest in another company to be distributed among the numbers (Sec. 494).

6. *Calling Meeting of Creditors* : If the liquidator at any time is of opinion that the company is insolvent, he must summon a meeting of the creditors, and lay before the meeting a statement of the assets and liabilities of the company (Sec. 495). Thereafter the winding up proceeds as if it were a creditors' voluntary winding up and not a members' voluntary winding up (Sec. 498).

7. *Calling General Meeting at the End of One Year:* In the event of the winding up continuing for more than one year, the liquidator must call a general meeting of the company at the end of the first year from the commencement of the winding up at the end of each succeeding year, or at the first convenient date within three months from the end of the year or such longer period as the Central Government may allow, and must lay before the meeting an account of his acts and dealings and of the conduct of the winding up during the proceeding year (Sec. 496).

8. *Financial meeting and dissolution [Section 497] :* When the affairs of the company are fully wound up, the liquidator shall perform the following duties.

(a) He shall make up an account of the winding up, showing how the same has been conducted and how the property has been disposed of.

(b) He shall call a general meeting of the company for laying before it the said accounts. This meeting is the final meeting of the company. The meeting shall be called by advertisement specifying the time, place and object thereof. The advertisement shall be made not less than one month before the meeting in the official gazette and also in some local newspaper where the registered office of the company is situated.

(c) Within one week after the meeting, the liquidator shall send a copy of the account to the registrar and the official liquidator and also a return of the holding of the meeting and the date thereof. If the copy is not so sent or the return is not so made, the liquidator shall be punishable with fine which may extend to Rs. 50 for every day during which the default continues.

The registrar on receiving the account and either of the returns shall forthwith register the same. The official liquidator on receipt of the account and

the return is required take a scrutiny of the books and papers of the company. The liquidator of the company, its past and present officers, shall afford and opportunity to the official liquidator for this purpose. The official liquidator shall send a report of the scrutiny to the court. If the report shows that the affairs of the company have been conducted bona fide i.e. not in a manner prejudicial to the interests of its members or public interest, then from the date of the submission of the report to the court, the company shall be deemed to be dissolved.

If the report shows that the affairs of the company have been conducted in a manner prejudicial to the interests of members or public interest, the court shall by order direct the official liquidator to make a further investigation of the affairs of the company. For this purpose the court shall invest him with all such powers as it may deem fit. On receipt of the report of the official liquidator on such further investigation the court may either make an order that the company shall stand dissolved or make such other order as the circumstances of the case brought out in the report permit.

Creditor's Voluntary Winding Up : Where a company proposes to wind up voluntarily and the directors are not in a position to make the statutory declaration of solvency, the winding up is a creditor's voluntary winding up. The provisions for creditor's voluntary winding are similar to those applicable to the member's voluntary winding up except that in the former, it is the creditors who appoint the liquidator, fix his remuneration and generally conduct the winding up. Sections 500 to 509 deal with creditor's voluntary winding up. They are discussed as under:

1. *Meeting of creditors* (Section 500) : When the declaration of solvency is not made by the directors, the company shall cause a meeting of the creditors of the company to be called for the day or for next following day on which the

resolution for voluntary winding up is to be proposed. Notice of the meeting of creditors shall be posted to creditors simultaneously with notice of the meeting of the company. The notice calling the meeting of the creditors shall be advertised once at least in the official gazette and once at least in two newspapers circulating in the district where the registered office of the company is situated. The board of directors shall lay before the meeting of the creditors a full statement of the position of the company's affairs together with the list of its creditors and the estimated amount of their claims. One of the directors must preside at the meeting.

2. *Notice to registrar* (Section 501) : The company shall give notice of resolution passed at the creditors meeting to the registrar within 10 days of its passing.

3. *Appointment of liquidator* (Section 502) : The creditors and the company shall appoint a person to be the liquidator . If different persons were nominated, the person nominated by the creditors shall be the liquidator. Any director, member or creditor of the company may, within 7 days of the nomination made by the creditors, apply to the court for an order that the person appointed by the company shall be the liquidator. Where no person is nominated by the creditors, the person nominated by the company shall be the liquidator. On the other hand, if no person is nominated by the company, the person nominated by the creditors shall be the liquidator.

4. *Committee of inspection* [Section 503] : The creditors at their meeting may appoint a committee of inspection consisting of not more than five persons. Where such a committee is appointed, the company may also appoint at a meeting such number of persons not exceeding five to act as the members of the committee.

The creditors may resolve that any of the person appointed by the company ought not to be the numbers of the committee of inspection. In such cases, unless the court otherwise directs, they cannot act on the committee. The court may appoint other persons in place of persons objected to.

5. *Liquidator's remuneration* [Section 504] : Remuneration of the liquidator may be fixed by the committee to inspection or the creditors if there is no committee of inspection. Otherwise the court may fix his remuneration. Remuneration fixed as above cannot be increased in any circumstances.

6. *Power of board to cease* [Section 506] : The board usually ceases to function on appointment of the liquidator. The board may act in so far as the committee of inspection (if any) or the creditors in general meeting may sanction the continuance thereof.

7. *Vacancy in office of liquidator* [Section 506] : The creditors in general meeting may fill up any vacancy caused in the office of the liquidator other than a liquidator appointed by or by the direction of the court.

8. *Meeting at the end of each year* [Section 508] : Where the winding up continues for more than a year, the liquidator shall call a general meeting of the company and a meeting of the creditors at the end of the first year from the commencement of the winding up and at the end of each succeeding year or within three months from the end of the year or such longer period as the central government may allow. The liquidator shall lay before the meeting an account of his acts and dealings and of the conduct of the winding up during the proceeding year.

If the liquidator fails to comply with these provisions he is liable to be fined upto Rs. 100 in respect of each failure.

9. *Final meeting and dissolution* [Section 509] : As soon as the affairs of the company are wound up, the liquidator shall make up the account of the winding up showing how the winding up has been conducted and property of the company has been disposed of. He shall call a general meeting of the company and a meeting of the creditors for the purpose of laying the accounts before the meetings. Each such meeting shall be advertised in the official gazette and also in some newspaper circulating in the district where the registered office of the company is situated. Within a week after the meeting, the liquidator shall send to the registrar a copy of the account and a return which will be registered. Thereafter the procedure is the same as in member's voluntary winding up.

8.4.3 Difference between member's voluntary winding up and creditor's voluntary winding up

1. Declaration of solvency is a must in a member's voluntary winding up, whereas it is not necessary in a creditor's voluntary winding up.
2. It is unnecessary to have a creditor's meeting in the case of member's voluntary winding up, whereas in the case of creditor's voluntary winding up, it is a statutory duty of the company to call a meeting of the creditors.
3. The liquidator is appointed by the members in case of member's voluntary winding up whereas both members and creditors appoint liquidator in case of creditor's voluntary winding up.
4. There is no committee of inspection in case of members who control the winding up, but in case of the latter there is one.
5. In the case of member's voluntary winding up it is the members who control the winding up, and the creditors do not play an active role as the company is

solvent. In the case of creditor's voluntary winding up, it is the creditors who control the winding up as the company is considered to be insolvent.

6. In a member's voluntary winding up, the liquidator can exercise some of the powers with the sanction of a special resolution of the company. In a creditor's voluntary winding up, he can do so with the sanction of the court or the committee of inspection or of meetings of creditors.

8.5 WINDING UP SUBJECT TO SUPERVISION OF COURT

At any time after a company has passed a resolution for voluntary winding up the court may make an order that the voluntary winding up will continue, but subject to the supervision of the court and with such liberty for creditors, contributories and others to apply to the court on such terms and conditions as the court thinks fit (Section 522).

A petition for the continuance of a voluntary winding up subject to the supervision of the court must be deemed to be a petition for winding up by court (Section 523).

Power of court to appoint or remove liquidators : Section 524 empowers the court to appoint or remove liquidators at the time of taking the supervision order or subsequent thereto. When a supervision order is made the court may appoint an additional liquidator or liquidators. The court may remove any liquidator so appointed or any liquidator continued under supervision order and fill any vacancy occasioned by the removal, or by death or resignation.

The court may appoint the official liquidator as liquidator. The court may also appoint or remove a liquidator on an application made by the Registrar.

Powers and obligation of liquidator : The liquidator appointed by the court on or after making the supervision order will be in the same position as a liquidator appointed in the voluntary winding up i.e. he will have the same powers and be subject to the same obligations as if he had been duly appointed as a liquidator in a voluntary liquidation (Section 525).

Effect of supervision order : The effect of a supervision order is to allow the liquidator to wind up the company as in a voluntary winding up, subject only to any restrictions imposed by the court. He can exercise all the powers, without the sanction or intervention of the court in the same manner as if the company were being wound up voluntarily.

The court will have wide powers as in compulsory winding up. It may stay suits or legal proceedings. The court can also make or enforce calls and all other orders necessary for beneficial winding up of the company. (Section 526).

Advantages of order of supervision : The advantages in winding up subject to the supervision of the court are :

1. Suits and other actions against a company are automatically stayed.
2. The court controls the appointment and removal of liquidator.
3. The court can exercise all other powers which it might have exercised if an order had been made for winding up the company altogether by the court.

8.6 CONSEQUENCES OF WINDING UP

The consequences of winding up may be discussed under the following heads :

1. *Consequences as to Shareholders :* A shareholder is liable to pay the full

amount upto the face value of the shares held by him. Not only the present, but also the past members are liable on the winding up of the company. The liability of a present member is the amount remaining unpaid on the shares held by him, while a past member can be called upon to pay if the present contributory is unable to pay.

2. *Consequences as to Creditors* : A company, whether solvent or insolvent, can be wound up under the Act. In case of a solvent company, all claims of its creditors when proved are fully met. But in case of an insolvent company, the rules under the law of insolvency apply.

A secured creditor need not prove his claim against the company. He may realize his security and satisfy the debts. For deficiency, if any, he may put his claim before the liquidation. The secured creditor has also the option to relinquish his security and to prove the amount as if he were an unsecured creditor.

3. *As to employees and Officers* : A winding up order is deemed as a notice of discharge to the officers and employees of the company, except when the business of the company is continued [Sec. 445 (3)].

4. *As to Proceedings Against the Company* : As soon as the winding up order is passed :

- (a) no new suit or other legal proceeding against the company can be commenced.
- (b) all existing suits cannot be proceeded with except with the leave of the court.
- (c) even in voluntary winding up, the court may restrain proceedings against the company, if deemed fit.

8.7 SUMMARY

Winding up is the last stage in the life of a company. It means the proceedings by which the company is dissolved. The winding up of a company may be of three kinds, viz., (1) winding up by the court, (2) voluntary winding up. It may be (a) a member's voluntary winding up (b) a creditor's voluntary winding up, and (3) Winding up subject to the supervision of the court. Winding up by the court may be ordered in cases mentioned in Section 433. The court will make an order for winding up on an application by any of the persons enumerated in Section 439. Winding up by the creditors or members without any intervention of the court is called voluntary winding up. In this, the company and its creditors are left free to settle their affairs without going to the court, although they may apply to the court for directions or orders if and when necessary. Voluntary winding up may be under the supervision of the court. At any time after a company has passed a resolution for voluntary winding up, the court may make an order that voluntary winding up shall continue, but subject to supervision of the court.

8.8 KEYWORDS

Compulsory winding-up: Winding up by the court, also called compulsory winding up, may be ordered in cases mentioned in Sec. 433 of the Companies Act, 1956. The court will make an order for winding up on an application by any of the persons enumerated in Sec. 439.

Commercial insolvency: If a company is unable to meet its current liabilities, it is commercially insolvent and liable to be wound up.

Voluntary Winding up: Winding up by the creditors or members without any intervention of the Court is called 'voluntary winding up', In voluntary winding up,

the company and its creditors are left free to settle their affairs without going to the Court, although they may apply to the Court for directions or orders if and when unnecessary.

Winding-up of a company: It is a process of putting an end to the life of a company. It is a proceeding by means of which a company is dissolved and in the course of such a dissolution its assets are collected, its debts are paid off out of the assets of the company or from contributions by members, if necessary.

8.9 SELF ASSESSMENT QUESTIONS

1. What is compulsory winding up or winding up by the court ? What are the grounds for compulsory winding up ?
2. When is the winding up of the company deemed to have commenced? What are the consequences of a winding up order?
3. What are the different kinds of voluntary winding up? Distinguish between members' voluntary winding up and creditor's voluntary winding up.
4. What is winding up subject to the supervision of the court? What are the advantages of a supervision order?

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Subject : Business Flow System
Course Code : BCA-201
Lesson : 9

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BUSINESS COMBINATION AND RATIONALISATION

STRUCTURE

- 9.0 Objectives
- 9.1 Introduction
- 9.2 Causes of combination
- 9.3 Types of combinaton
- 9.4 Forms of combination
- 9.5 Rationalisation
- 9.6 Summary
- 9.7 Keywords
- 9.8 Self Assessment Exercise
- 9.9 References/Suggested Readings

9.0 OBJECTIVES

After reading this lesson, you should be able to

- understand meaning and types of business combination;
- analyse causes of business combination; and
- know the features of rationalisation in Indian context.

9.1 INTRODUCTION

The Industrial Revolution paved the way for the development of the joint-stock enterprise and large-scale business. The doctrine of free competition combined with the expansion of markets has attracted a number of producers into the field. Competition has become increasingly acute. This has slashed the profits of producers and made them think of the ways and means by which unhealthy and wasteful competition could be avoided. Co-operation appeared to be the only way

out of this crisis. Industrial units, most of which functioned as joint-stock companies, began to associate together for a variety of purposes-sometimes to regulate the output or prices, sometimes to pool their resources for organising research and sometimes to establish monopolies in certain part of the market. In this way, the concept came into existence, as the combinations or combines of business units that joined together in varying degree for varying objectives. If a company or partnership is described as a simple association of persons formed for definite business purposes, the combinations could well be called compound associations of persons. Haney has said that combination was imply to become one of the parts of a whole, and a combination is merely a union of persons, to make a whole or group for the pursuit of some common purposes. It will be noted that the various units in combination are bound together by some common purposes. The purpose may be survival, growth and/or prestige. Thus firms may combine to ensure their survival in the face of competition or other threats or to seek avenues of growth and expansion. In some cases, they may be motivated by consideration or prestige that goes with large-scale business. Whatever the purpose, combination involves association and integration among the firms.

9.2 CAUSES OF COMBINATIONS

The growth of business combinations cannot be traced to any one particular reason or factor. It has been the outcome of several complex forces which cannot easily be separated from each other. Attempts have, however, been made by some authorities to state some of the important causes which have facilitated or led to the formation of combinations of different kinds. Haney classified these causes into three categories : (i) driving or impelling forces, (ii) beckoning forces, and (iii) facilitating causes. According to him, the driving forces included (a) the decrease in the opportunity for speculative gains, and (b) intense

competition. The beckoning conditions, in his opinion are (a) opportunity for gain, (b) protection to industries, and (c) the possibilities of gain by over capitalization. The facilitating conditions mentioned are : (a) tariff, (b) the development of the joint-stock company form of organisation, etc. These and some of the other salient causes, forces and conditions leading to the growth of business combinations are discussed here under :

1. **Wasteful Competition :** The severity and intensity of competition in the business world is one of the most important forces that have led to the development of business combinations. Towards the end of the nineteenth century there was a tremendous expansion of market. Industry switched over from production on a modest scale to large-scale production. It was under these circumstances that competition tended to be wasteful, intense and acute. In this grim struggle for existence, the small and relatively inefficient producers were driven out of the market. The big concerns remained in the arena to fight it out among themselves. The business giants found that they were fighting a losing battle. They could not switch over to other lines of productions without heavy loan because they had installed specialized equipment at heavy capital outlays. Thus, business units were driven towards combination by competition which had become acute and wasteful.

2. **Advantage of Large-scale Operation :** Production and organisation on a large scale bring a number of well-known advantages. It has already been observed that a large-scale business organisation can effect considerable economy in production costs by bulk purchase of materials, investment in industrial research, spreading of overhead over large quantities of output, and by utilising waste products. Similarly it means a great deal of economy and efficiency in management also. In the sphere of marketing, it enjoys definite advantages over smaller concerns through its large-scale marketing organisation and well-organised advertising and sales campaign. Likewise, it finds it easier to raise finances at cheaper rates and

at easier terms by virtue of the security of its assets. All these advantages impelled businessmen to form joint-stock companies to run large-scale organizations. Subsequently, most of the firms were tempted to combine and join hands for re-shaping the economics resulting therefrom.

3. **Desire for Monopoly Power :** Monopoly lead to the control of market and generally means large profits for business concern. Naturally, the businessmen controlling competing units have quite often been tempted by the power of monopoly. Monopoly succeeds particularly well in those products, which enjoy inelastic or less elastic demand. That is so because the monopolist can raise the price without fear of substantial reduction in demand in such case. Generally, necessities have such inelastic demand. The desire to secure monopolistic position has certainly prompted producers to join together under one banner.

4. **Business Cycles :** The business or trade cycle are the ups and down occurring at fairly regular intervals in capitalist economies. These consist of booms (another name for the period of peak prosperity) and depressions (periods of crises and reduced economic activity). During a boom period, there is generally an unusual rapid growth of firms which spring up to reap the rich harvest of profit. These firms include all types - the efficient and the inefficient and the big and the small. Such, however, is the nature of economic activity in uncontrolled economies that a boom must necessarily be followed by a depression. During a period of depression, economic activity comes down to the lowest level. The demand for the products is very poor and the producers have to offer their goods at rock-bottom prices. The inefficient concerns which produce at higher cost of production find it extremely difficult to continue to produce. In time of crisis, when they are faced with the possibility of having to close down, they think of co operation and combination. Large-scale mergers may take place; or attempts may be made to

regulate supply and raise the level of price through combined efforts of a number of firms. Depressions are, therefore, characterised not only by a large number of closures, but also by wholesale combination of businesses. Quite often, shrewd businessmen force that the current boom will be followed by a depression and prepare themselves for the forthcoming crisis by combining during the boom itself.

5. **Influence of Tariffs :** Tariffs have been referred to as the "mother of all basis" Normally in every country, custom duties on products, imported from foreign producers, are levied so that the foreign product sell at a higher price than the domestic products, and the home industry is saved from competition from abroad. Encouraged by such policy of protective tariff, a number of producers spring up in the home industry to take advantage of the protection offered by government. Competition in the home industry ultimately becomes so intense necessitates the policy makers to change high prices and maximize their profits a along as they are protected against foreign competition by means of high import duties on imported goods. In India, the Government afforded protection to the sugar industry in 1932. In 1937, "Sugar Syndicate" was formed for selling the sugar produced by its member-producers. It must be recognized however, that "protection can only facilitates the rise and growth of a combination where the essentials for business combining effectively exist independently.

6. **Individual Organising Ability and Ambition :** The scarcity of talent for organization has also induced the formation of combinations in the business world. One notable feature of the present-day industry is that it has developed so rapidly that enough trained and talented people are not available to organise and manage it properly. The business units far outnumber the skilled and shrewd business managers. Many of the units have to combine to take advantage of the organising ability of these by less brains. On the other hand, combinations may be formed

also due to the ambitious nature of certain business magnates. A shrewd businessman with lot of organising and managerial talent may weave around him a complex pattern of business to satisfy his personal ambition as also to make use of this ability. In India, the managing agents, who were responsible for beginning several units under common control, offer an illustration of how a few enterprising people can help the formation of combinations.

7. **Respect for Business :** A striking feature of the present-day world is the general craze and respect of the large size. People take pride in owning and/or being associated with things of large size. In the business world too, businessmen are ever trying to own firm of large size. They may bring several firms together under one banner so that they will be talked of as big business magnates. Not only that, even the general public is easily swept off its feet by the products of giant-size concerns. This tendency has also encouraged the formation of large-sized combinations in the business world.

8. **Rationalisation :** Rationalisation scheme calls for joint and co-operative action for many purposes - say, for regulating prices and output, scrapping idle plant capacity, for planned utilisation of scarce materials and for standardisation of products, etc. Such actions can be taken only through some form of combination of the units constituting an industry. Combination may, in fact, be regarded as an integral part of rationalization. In this way, rationalisation can be said to have furthered the cause of combination movement in industry. In India, the Indian Jute Mills Association is a combination that was formed with the object of introducing and enforcing certain measures of rationalisation in the jute industry.

9. **Miscellaneous :** Besides the major factors and causes of the development of business combinations discussed above, the following causes have been mentioned in this connection by various authorities on the subject.

(a) **Joint-stock enterprise :** The development of corporate enterprise has also facilitated the growth of combinations. A few persons can easily have controlling interest in a large number of business organizations by purchasing shares of different companies. If these men are willing to joint together, the business firms can easily be combined. All they need to do is to transfer their shares to the new company (i.e. the combine).

(b) **Patent laws and stock exchanges :** Combinations may be formed by the units which want to take advantage of the patent rights standing in the name of a particular unit. Similarly, stock exchanges provide opportunity to businessmen to purchase the shares of several companies with a view to gaining control over them.

(c) Combination in a certain section of an industry is likely to lead to combinations in other sections too. If coal mines form a combination, the iron and steel mills may buy up coal mines to avoid paying a very heavy price for coal.

(d) **Chance of gain by over-capitalization :** Many promoters promoted combination of business units because they were looking for speculative profits in over-capitalization giant-sized concerns. Sometimes, the promoters did make huge profits, thus tempting others to form such combinations. When the United States Corporation was formed, its total capital was \$ 1,300 million out of which Carnegie, the promoter, received \$ 500 million for his remuneration.

(e) **The enhanced importance of distribution :** Haney is of the view that with the market acquiring an international character, the function of marketing goods over wide areas and long distances has become more important than the technical problem of production. The producer may find that the only way to control the situation, and reduce the risks of buying and selling lies in their combination. In this manner, combinations of producers may be formed to meet the risks arising out of the increasing importance of the function of distribution.

9.3 TYPES OF COMBINATIONS

Business combinations may take a wide variety of forms ranging from a loose and informal agreement among producers to a complete fusion of businesses. Fundamentally, however, they are the outcome of (i) horizontal, (ii) vertical, (iii) lateral, (iv) circular, or (v) diagonal integration. It is quite possible that a combination may be a mixture of two or more of these fundamental types. A brief assessment of the economies of these types is attempted here.

1. **Horizontal Combination (also called parallel or unit or trade combination).** Such combination in the industrial and trade world are brought about through horizontal integration. It will be recalled that horizontal integration refers to the combinations of plants at the same stage of production or at the same plane in trade or commerce. A horizontal combination, therefore, come into being when units carrying on the same trade or pursuing the same productive activity join together with some common end in view. A combination of four steel mills or cloth dealers doing similar business belong to the category of horizontal combinations.

Examples of such combinations are provided by the Sugar Syndicate and Associated Cement Companies (ACC) in India.

Though it is difficult to trace the original purpose of forming such combinations, in the present-day business world they serve to reduce the intensity of competition, do away with some of the evils of cut-throat competition and bring several economies of large-scale organization. The intensity of competition is naturally reduced when a number of units competing in the same line of business join together. Similarly, when the continuing units take such steps as restriction of output, fixation of a common price, organisation of sales on a joint and co-

operative basis and other adjustments of similar nature, much of the evil of cut-throat competition is done away with. The combining units engaged in the same business can well take advantage of the various economies associated with large-scale production by making common purchase, pooling resources for research, engaging top brains in management, and organising common advertising campaigns in place of wasteful competitive advertising. In short, a horizontal combination brings a number of external economies together.

It must, however be admitted that such a combination cannot guarantee market for the products, nor can it ensure a regular supply of raw materials. In fact, it may not only avoid cut-throat competition but may even lead to the formation of a monopoly and the concentration of industrial power in a few hands. The monopolistic power thus secured may be used to exploit the consumers.

2. **Vertical Combination (also termed as sequence or process or industry combination).** Vertical Integration, to borrow Prof. Robinson's words "is the combination of firms in successive stages of the same industry. It implies the integration of the various process of an industry hitherto controlled by different firms. This type of combination is almost peculiar to an industry where a material passes through a series of distinct processes. Hence the term industry combination. Such integration may start from a manufacturer who wants to control the market add retail shops to his organisation or form a marketing concern which joins hands with a manufacturing organization. The former is called forward integration and the latter backward integration. In a vertical combination, firms operating at different places in an industry come together. Thus units engaged in ginning of cotton, carding, pressing and bailing, spinning, weaving and bleaching may join together to form a vertical combination.

Vertical combinations are brought into existence with the following objectives in view : (a) to eliminate the wasteful and unnecessary expenses involved in carrying on the connected process separately, (b) to eliminate middlemen between various units, with a view to avoiding unnecessary expenses on them, (c) to secure economies in marketing, advertising and transport, and (d) to maintain control over the quality of raw materials and finished products. Beside ensuring certainty of the supply of raw material and the marketing of finished product, vertical combinations bring economies of advertising, storage transport, etc., unification of the various processes of an industry under common management which, keep the combining units away from the evil effects of straight cycle by weaving them into a strong and unified organisation and eliminates the intermediaries' profit that add to the cost of production.

3. **Lateral or Allied Combination.** Such a combination is the result of lateral integration. Lateral integration refers to the combination of those firms which manufacture different kinds of products though they are allied in some way. It may take either of the two forms : (i) convergent lateral integration, and (ii) divergent integration.

Convergent lateral combination is brought about when various firms join together with a major firm to supply to it raw materials or basic materials. Thus, the different types of products manufactured by the combining units become the raw materials of a single firm which can be regarded as the centre of nucleus of a combination of this kind. In other words, the dissimilar products of the different combining units converge on the major firm that makes use of these for its own production. An example of this type is provided by a printing press which may combine with units engaged in the manufacture of paper, ink, types, cardboard, printing machinery, etc., to get supply of equipment and raw materials from the integrated units.

Divergent lateral integration or combination takes place when a major firm supplies its product to the other combining firms which use it as their raw material. Thus, the product of one firm becomes the raw material of many other firms. This will happen where a number of product can be manufactured from a material produced by a firm. The best example of such combination may be found in a steel mill which supplies steel to a number of allied concerns for the manufacture of a variety of product like tubes, wires, nails, machinery, building material, locomotives, etc.

4. **Diagonal Combination (or service combination)** : Such combination is brought about by diagonal integration. Diagonal integration take place when a unit providing initial auxiliary goods and service to a industry is combined with a unit operating in the main line of production. In such a case, the good and services required for the main process of production will be provided inside the organization itself. Thus if an industrial enterprise combines a repair workshop for maintaining the tools and machines in good order, it will be effecting diagonal integration and such a combination can well be termed as diagonal combination. The main advantage of such combination is that it enables the main unit to become self-sufficient and saves them from dependence on outside sources of supply for auxilliaris.

5. **Circular Combination (also called mixed combination)**. When firms belonging to different industries and producing altogether different products combine together under the banner of a central agency, it is referred to as a mixed or circular combination. None of the features of the other type of combinations are found in this type. If a sugar mill combine with a steel or a cement factory, it will be an example of mixed combination. The underlying idea of such combination is to secure the advantages of administrative integration through common

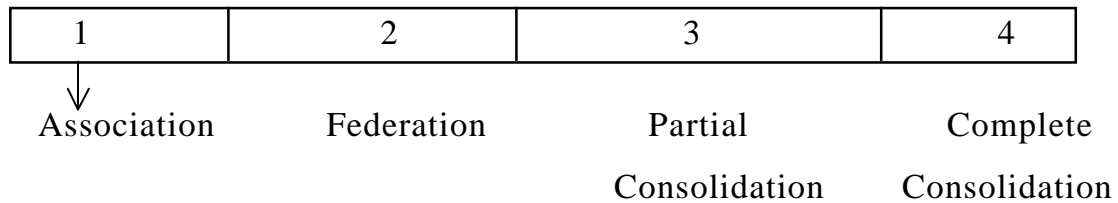
management. Combination of this type is generally brought about by ambitious and enterprising businessmen who want to extend their operations to diverse fields of industry. In India, the managing agents like the Tatas, Birla, Martin Burn and Co., etc., have been effecting such combination on a large scale.

9.4 FORMS OF COMBINATIONS

The forms of combinations have been classified by Haney as follows:

- I. *Simple combinations, i.e.* direct combination of natural persons as in partnership of companies.
- II. *Compound Combinations i.e.* combination of associations of natural persons. According to the degree of fusion among combining firms, it may be :
 - (i) An association, i.e. the loosest agreement directly between representative of different associations like trade associations, chamber of commerce and industry, information agreements, etc.
 - (ii) A federation, i.e. combination of organizations which remain separate and retain considerable autonomy like pool and cartels.
 - (iii) *A consolidation, i.e.* a combination in which members may or may not remain nominally separate, but direction of business is fused. It may be either :
 - (a) *A partial consolidation, i.e.,* direction of business organisation consolidated through stock ownership, with separate existence formally maintained, or
 - (b) *A complete consolidation* which may be by (i) merger, i.e., one business organisation absorbed by another, or by (ii) amalgamation, i.e., member of two or more organizations coalesce in to form a new organisation.

The above form combinations may be represented on a continuum as follows :



It will be noticed that the degree of integration is the lowest on the left end of the scale at No.1. As we move towards the right, the degree of integration increases till we reach the right extremity of the scale where the integration is perfect and complete.

9.5 RATIONALISATION

9.5.1 Meaning of rationalisation

In its broadest sense, rationalisation means the introduction of dictates of reason in our activities - both industrial and otherwise. Rationalisation has a history that is almost as long as that of mankind itself. All human progress has been possible only through the introduction of reason into human thought and action. Rationalisation is, therefore, a process that has gone on for ages leading mankind to the path of progress - social, cultural and material. In a narrower sense, however, rationalisation is a term that has been employed to reform or reorganisation of industry involving joint action on the part of firms on sound lines for achieving higher productivity. In its application to industrial activity, rationalization has a rather recent origin. It was in the early twentieth century that the term rationalisation was first used to refer to the new industrial revolution.

Granting that rationalisation stands for the introduction of rational thinking and logical methods in industry, the term is open to a variety of interpretations. This is so because everybody has his own notion of what can really

be regarded as rational thinking and action in the organisation and management of industry. Moreover, conditions and circumstances vary from time to time and country to country. Naturally enough then, the concept of rationalization has been interpreted in different ways and words by the various authorities at different times and in different conditions. To grasp the basic features of this concept, it will be useful to examine some of the definitions advanced by some renowned authorities including some international bodies.

1. *Prof. E.A.G. Robinson.* "Rationalisation refers to the re-organization of relationship between the firm and an industry". Prof. Robinson stresses here that rationalisation seeks not merely to regulate the internal working of a firm, but attempts to re-organise an industry on right lines. Its application is industry-wide.
2. *The World Economic Conference held at Geneva says,* "rationalisation refers to the method and technique of organization designed to secure the minimum waste of effort or material. These methods include the scientific organization of labour, standardisation both of material and products, simplification of procedures and improvements in the system of transport and marketing." This is a widely accepted definition.
3. *Advisory Committee on Management of the I.L.O. (137).* "Rationalization (a) in general is any reform tending to replace habitual, antiquated practices by means of an undertaking administrative or other service, (b) public or private business, tending to replace habitual, antiquated practices by means and methods based on systematic reasoning; (c) in a wider sense, it is a reform which takes a group of business undertakings as a unit and tends to reduce the waste and loss due to unbridled competition by concerted action based on systematic reasoning; (d) in the widest sense, "is a reform tending to apply means and methods based on systematic reasoning to the collective activities of large economic social groups".

The Committee felt that the term rationalisation as understood in English-speaking countries is expressed well by definition (c) above. The idea defined in (b) is usually expressed by the term reorganisation and that defined in (d) by social and economic planning.

It should be noted that various definitions presented here emphasise different features of rationalization. Nevertheless, the basis of rationalization lies in a scientific attitude toward the problems besetting industrial sector of the economy, or a particular industry. It is essentially directed towards the removal of all possible causes of waste and inefficiency in industry, and the establishment of conditions which will be conducive to higher productivity. "The essence of rationalization to use Mr. Gil's words, "is a revolutionary change of methods which scraps obsolete traditions and unsystematic routine methods, replacing them by principles and methods of a scientific nature.

9.5.2 Aims of Rationalization Movement

Rationalization was originally conceived as a scheme whose implementation promised hopes for the reconstruction of the economy. These hopes, as we observed earlier, were realised and rationalisation drew the attention of many countries of the world too. Though the circumstances in different parts of the world have varied a great deal, and the measures of rationalisation adopted to cope with them, too, have not been uniformly the same everywhere, certain basic aims and purposes have always been associated with rationalization. The central object of rationalization has already been described as the removal of the various causes of waste and inefficiency. Around it, several other aims have sprung up from time to time. The aim and objects of this movement were laid down by the World Economic Conference at Geneva in 1927. According to the resolutions passed at the Conference, rationalization aims at :

- (i) securing the maximum efficiency of labour with minimum effort.
- (ii) eliminating waste of raw material and power,
- (iii) simplifying distribution of commodities, by eliminating unnecessary transport, excessive financial burden and useless multiplication of middlemen.
- (iv) greater stability and higher standard of life,
- (v) lower prices of good to customer, and
- (vi) large and more assumed remuneration to be fairly distributed among the various categories of products.

To sum up, the aim of rationalisation is to maximize productivity and distribute the gains arising from higher productivity equitably among all the parties concerned with an industry, namely, the producer, the workers and the consumer.

9.5.3 Measures of Rationalisation

If rationalization involves an attack on the causes of low productivity, it will be necessary to ascertain, in the first place, the reasons for waste and inefficiency. The history of industry all over the world reveals the following the major cause of wastage, inefficiency and low productivity.

1. **Scramble for Scarce Resources.** Periods of shortages characterise almost all competitive economies. In such times, the resources of different kinds such as raw materials, equipment or finances are all in short supply relative to the demand for them. This creates some kind of a scramble for the scarce resources. Each producer is anxious to secure the largest possible share of the resources without caring either for the other producers or for the economy as a whole and makes an all-out attempt for the other producers or for the economy a whole and make an all-out attempt for this purpose. In such a situation, only a handful of firms may be able to get all for this purpose.

Obviously, they will not be able to make proper use of their shares, and whatever they are able to get may be wasted. Another undesirable consequence of scramble for scarce resources is that many of the firms may have to spend heavily on the acquisition of these resources. This may naturally raise the cost of production considerably, and will result in lower productivity. In these circumstances, rationalization can be helpful only if it can tackle the problem of the scramble for scarce resources effectively.

2. **Idle Plant Capacity :** There is general tendency among firms to increase their plant capacity considerably during periods of prosperity. This is done in the fond hope that the demand for the products of each unit of an industry will continue to be what it is during the unusually preposterous period of booms. This hope is, however, seldom justified by the events that follow.

The oncoming of a period of depression has an extremely adverse effect on demand. Although there is a fall in the demand, the firms continue to produce at the same pace and with the same plant capacity. However, it does not take long for the firms to realise that they are producing far in excess of demand and are wasting their resources. This realisation leads to a cut in production, and the plant and equipment work much below the maximum installed capacity : in fact, a part of it has to remain idle. The idle plant is obviously a source of waste because it involves unproductive costs in the form of interest and depreciation which have to be borne whether the plant is working or not. An industry suffering from over-capacity cannot hope to achieve minimum costs and maximum productivity unless the idle plant capacity is ruled out. Rationalisation is, therefore, concerned with the removal or scrapping of idle plant capacity. This may be regarded as an important measure of rationalisation.

3. **Unnecessary Varieties :** One of the causes of wastage in industry that can

be traced to competition among firms is the existence of large number of unnecessary varieties of some products in the market. Varieties multiply partly on account of the illogic of the consumers and partly due to the actions of producers. The consumers are very soon tired of using the same old thing and desire a new brand name, a new shape and design, or a different colour for the same type of product every now and then. Attractive advertisements are meant to exploit this eagerness of the consumers for a new brand or variety of the products already being used. There is an irrational craze for novelty among the consumers. A new firm entering the market can hope to establish itself on firm ground only when its product is different from the others already in the market at least in respect of its appearance. Likewise, firms already established in the field have also to introduce new varieties of their products from time to time in a bid to win customers over from the rival firms. By and by, the varieties become so large in number that every producer produces a particular variety on a small scale to cater to a small part of the market. The economies of large-scale production can no longer be reaped, and the cost of production cannot be minimized. The consumers' demand for more and more of new varieties is illogical not merely because they demand change in the variety without any sound reason, but also because they have to pay a higher price for this. Reduction in the number of varieties is yet another measure of rationalization. Standardisation of products is another name for this step. Standardisation of products is necessary to avoid and eliminate the wasteful expenditure that is incurred on advertising new varieties, and utilising the services of more middlemen (wholesalers and retailers) as also for raising production to the optimum level and minimising the cost of production. As a measure of rationalisation, standardisation is intended to reduce both the cost of production and the cost of distribution.

4. **Obsolete Machinery.** Production with out-of-date machinery in plants of

less than the optimum size is, for obvious reasons, uneconomical. Efficiency can be increased only when adequate steps are taken for the modernization of plant and the replacement of obsolete machinery by new up-to-date machinery. To take the case of the present-day industry, man-operated machinery is fast becoming obsolete with the invention of labour-saving gadgets and automatic machinery. If, therefore, the firms, in an industry discard the old machinery and equip their plants with automatic machinery, productivity can be increased many times. Similarly, if the plants are properly managed by people who are well versed in the latest techniques of management, productivity is bound to rise. The replacement of obsolete machinery by up-to-date machinery and the increase in the efficiency of management at the plant level or industrywide scale may, therefore, be regarded as important measures of rationalisation. Sometimes (as in India presently), this aspect is given so much of importance that updation is considered to be the whole function of rationalization. Automation and modernization of plant have far-reaching implications which are quite often, willfully lost sight of. There is hardly any doubt about the fact that these measures will leave some people unemployed, at least immediately. If these steps are taken very fast, there is a danger of large-scale unemployment of workers. That will run counter to the very basis of rationalisation because it will mean the wastage of human resources and lack of rational thinking in the part of management and the employers. The programme of automation, etc., should therefore, be introduced gradually so that unemployment does not assume serious dimensions.

To sum up, the basic features of rationalisation may be stated as under:

- (i) *Combination*, Rationalisation calls for the amalgamation or merger of small or weak units with big and efficient units. Moreover, it requires joint and united auctioning various matters which are intimately connected with efficiency such

as the removal of over-capacity, the planned utilisation of scarce resources, etc. This will necessitate setting up some joint authority in which the powers of control are vested.

(ii) *Standardisation.* Standardisation of products is another important feature of rationalisation. It calls for the elimination of unnecessary varieties and the restriction of production to a few varieties. In this manner, each variety can be produced at the optimum level, i.e. at the point of the lowest average cost of production. It will also put an end to the wasteful expenditure on competitive advertising and cross-freights.

(iii) *Specialisation.* Specialisation is a feature of rationalisation that follows from standardisation of production. When production is concentrated over a limited number of varieties and is carried on by a small number of efficient and powerful units, each firm tends to specialise in a particular variety. Such specialisation brings a number of economies including conservation of resources and avoidance of cut-throat competition in its wake.

(iv) *Simplification.* Both standardisation and specialization of production lead to simplification of production. This, in turn, means a rise in productivity through increased production and curtailed costs. It further leads to increased sales for each variety.

(v) *Mechanisation and modernisation and automation of plant.* Rationalisation seeks to mechanize the functions which were being performed by human labour and to replace plant that has grown out-of-date with better machinery and equipment. In other words, automation is one of the distinctive features of rationalisation.

(vi) *Scientific managements on industry-wide scale.* Rationalisation calls for

a radical change in the method of management in the various firms constituting an industry. The traditional style of unsystematic management must give place to management based on scientific investigation. The systematic attempt at raising the efficiency of management will naturally lead to higher productivity which is the goal of rationalisation.

(vii) *Industrial research.* Rationalisation banks heavily on industrial research for determining the most economical processes of production. Industrial research tries to find out such processes and enable the quality of goods to be improved.

(viii) *Social objectives.* Rationalisation is concerned not merely with a rise in productivity; it is concerned equally with prosperity of all sections of society. The benefits of rationalisation should be shared by producers, workers and consumers alike. The producers should be able to reduce costs and increase profits. The workers should receive their share of prosperity resulting from rationalisation in the form of increased earnings, smaller work-loads and more amenities of social life. The consumers must get better quality of products at relatively cheaper prices. Schemes of rationalisation should not be undertaken at a speed that will cause large-scale unemployment of workers in industry.

9.5.4 Advantages of Rationalisation

1. Rationalization ensures stability within the industry as well as in the economy.
2. It prevents wastages of all kinds.
3. It regulates consumption and production through simplifications, standardisation and common agreements. Unnecessary and superfluous varieties of the products are avoided.
4. Better and proper utilisation of the resources is made possible through the

- allocation of resources, sales and output quotas.
5. It improves the worth of individuals through education, training and placement.
 6. It results in reduced cost of production, through mechanisation, specialisation and modernisation.
 7. It assures the optimum use of financial resources.
 8. It is possible to undertake common research programmes by the industry as a whole and each unit has to contribute its bit. So there is a pooling of common funds, common efforts and common minds to the advantage of all units of the industry.
 9. It brings about prosperity of the unit, industry, society and all units of the country.
 10. Rationalisation is the enemy of inefficiency.

9.5.5 Dangers of Rationalisation

1. It creates monopolies and combinations which are detrimental to the interests of the consumer in particular and the society in general.
2. In spite of all the assurances, promises and efforts, it is bound to result in unemployment and therefore, workers oppose rationalization scheme.
3. Workers object to rationaliation because it reduces the workers to mechanical tools because of mechanisation, modernisation and automation.
4. It also results in speeding up of the workers through intensification and workers feel that they are exploited.
5. Rationaliation requires huge amount of money which cannot be financed by

developing and poor economies. It is more capital intensive than labour intensive. Countries like India facing the problem of unemployment cannot adopt such schemes.

6. Managements may not prefer to undertake scheme of rationalisation as the workers may resent.
7. Because of high productivity, the markets may be flooded with excessive products resulting in fall in prices. Thus, the entire economy may be disturbed.

9.6 SUMMARY

The business combination is outcome of several complex forces which cannot easily be separated from each other. Attempts have, however, been made by some authorities to state some of the important reasons which have led to the formation of combinations of different kinds. On the other hand, rationalisation is broader concept which is application of mechanization, modernization, standardization and automation in industry wide scale with an intention to eliminate incompetent and sick unit from the industry itself, so that the entire industry becomes totally efficient. Rationalisation is a continuous process and different combinations may come out in due course of time. Hence, combinations and rationalisation go hand to hand in an economy.

9.7 KEYWORDS

Business combination: It refers to the combination of business units that join together in varying degree for varying objectives. It implies to become one of the parts of a whole.

Circular combination: When firms belonging to different industries and producing all together different products combined together under the banner of

a central agency, it is referred as a mixed or circular combination.

Combination: A selection made from a set of items is regarded as a combination. If the order of items within the selection is immaterial.

Diagonal combination: Diagonal integration takes place when a unit providing initial auxiliary goods and services to an industry is combined with a unit operating in the main line of production.

Horizontal combination: A horizontal combination comes into being when units carrying on the same trade or pursuing the same productive activity join together with some common end in view. A combination of four steel mills or cloth dealers doing similar business belongs to the category of horizontal combinations.

Rationalisation: Rationalisation refers to the re-organization of relationships between the firm and industry.

Vertical combination: It is the combination of firms in successive stages of the same industry. It implies the integration of the various processes of an industry heretofore controlled by different firms.

9.8 SELF ASSESSMENT QUESTIONS

1. Define the concept of business combination. Discuss various forms of combination with illustrations.
2. Compare and illustrate the concepts of business combination and rationalisation. What are the advantages of rationalisation.
3. "Rationalisation is as old a concept as human being" Discuss the statement.

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Lesson : 10

PUBLIC UTILITIES

STRUCTURE

10.0 Objectives

10.1 Introduction

10.2 Characteristics of Public Utilities

10.3 Special problems

10.4 Price policy

10.5 Ownership & Management

10.6 Summary

10.7 Keywords

10.8 Self Assessment Exercise

10.9 References/Suggested Readings

10.0 OBJECTIVES

After studying this lesson, you should be able to-

- understand the meaning and characteristics of public utilities;
- know special problems and price policy of public utilities; and
- learn about ownership and management pattern of public utilities in India.

10.1 INTRODUCTION

With the development of urban life, the organization of civic life becomes necessary. The life of a modern civilised people in a city banks rather heavily on the organization of the supply of certain goods, services and conveniences which are important to the point of being indispensable. The form of business organization established basically to arrange for the efficient and uninterrupted supply of such goods and services as are absolutely indispensable for a civilised community is referred to as a public utility organization. Competition in the supply of these essentials of life is obviously undesirable, for any variation in the quality of the products or services supplied to the consumers can have serious consequences leading to the dislocation of organised life in urban community. In public interest, therefore, the public utility concerns are organised as monopolies working under the control of a public authority that can look after such interests efficiently and effectively. The public interest in which public utility concerns are clothed requires that essential goods and services must be supplied to everybody in the community without discrimination and at reasonable prices. In the light of this description, following types of industries and services may be included among public utilities : supply of water and electricity, city passenger transport service i.e, omnibuses and transways, gas companies, etc.

10.2 CHARACTERISTICS OF PUBLIC UTILITIES

Fundamentally, and even historically, the concept of a public utility belongs more to the domain of law than to the sphere of economics.

As organisations charging for the service supplied and investing in equipment and of essential services, arrangement for the supply, spending on the public utilities are made by them. Let us exhibit some basic economic characteristics of public utilities :

1. **Supply of Indispensable Services** : The public utilities are by definition, engaged in the provision and supply of essential products and services which are basic to the continued existence of a civilised life in a community, particularly urban community. As noted earlier, these undertakings supply such necessities as water, electricity, gas, transport and communication services which are regularly required by a large section of the community.

2. **Inelastic Demand** : Since the public utilities supply such services to the community without which their life will be dislocated, the demand for their services is generally inelastic. A rise in water rates or electric charges may bring about some reduction in consumption by thrifty and less well-to-do sections of the community, but such reduction will not be substantial. People will generally be willing to pay for these essential facilities and conveniences even at the cost of some sacrifice as regards expenses on other items. This is true of the direct demand for the products and services supplied by public utilities to meet the immediate requirements of the people in respect of water, electricity, etc. But the derived demand, i.e. demand for a service like the supply of water or electricity, not for immediate consumption but for further production or some other indirect use, may not always be so very inelastic. If, for example, the rates for power supply

are increased the users may begin to use power generated by their own generators or may turn to other sources of power which are cheaper than the power supplied by a utility concern. In such a situation, the demand will be little elastic.

3. **Non-transferability of Demand** : "The consumer of a particular service cannot usually transfer his demand from one supplier to another unless he is willing to change the nature of his demand. This is largely due to the fact that there is usually only one undertaking at a particular place which is in a position to meet the requirements of a particular service. If a person is not satisfied with the supply of electricity in his town, he can change over to a new undertaking only if he shifts to another town. Likewise, if he does not find the prices charged for the supply of power reasonable he can use a substitute - using his own generator - to meet his power requirements but he cannot transfer his demand for power to any other producer for there is likely to be none else supplying power in a particular area. In a similar way, if a person does not like the city bus service, he may generally not find an alternative bus service though he can of course, hire a taxi or a scooter instead of availing himself of the service supplied by the transport company of the city.

4. **Heavy Fixed Capital Investment** : The supply of essential services by public utilities requires heavy investment of fixed nature in the equipment and machinery that has to be installed for the purpose. For example, a gas company must install a manufacturing plant, erect gas works, construct generating stations, reservoirs and pumping stations, and provide for a

network of pipes, cables and other apparatus for the distribution and regulation of gas to the consumers. A city transport system, water and electricity supply companies and railways have more or less similar requirements of fixed capital investment. Besides making a heavy initial fixed investment, a public utility concern has to meet heavy charges on account of maintenance, repairs and replacements etc. Its administrative costs are no less heavy for it will have to function on a large scale. The problem is made even more complex by the existence of indivisibilities of many of the factors of production engaged in supplying these services. This means that a large proportion of their costs does not vary and remains fixed but with small changes in demand. For example, if a Bus can accommodate 40 persons, its cost of operation will not be reduced if there are only 30 or 35 persons using its service at a time. There is very need in such circumstances of making the best and the maximum use of the available capacity so that the fixed costs get spread over the largest output, and the average fixed costs may be lowered. A further complication arises because of unevenness of demand. Demand is uneven because the services supplied by a utility concern cannot be stored. During the peak hours (for bus service, electricity, gas service, etc.) the demand generally rises very high while at other times it may be very low. For this reason, it becomes necessary to maintain extra capacity for peak hours. This is then, another reason necessitating a top-heavy fixed capital investment on the part of public utilities.

5. **Natural Monopoly** : Public utilities are generally considered to be natural monopolies in the sense that by the very nature of the services

which they supply. It is usually an essential condition of efficient operation that one undertaking should have a monopoly of the supply of the service in any particular area. Monopoly in the domain of public utility services becomes almost essential and inevitable on account of the following major considerations :

(a) Two or more utility undertakings (say, gas supply companies, telephone companies, electricity supply companies, etc.) cannot maintain perfect efficiency of essential services. For example, if there is competition among telephone companies, each company could refuse to exchange calls with its rival or it could delay inter-system calls. Such situations may well arise in other spheres of public utility services, too.

(b) If direct competition is permitted between two or more public utility undertakings, it will amount to duplication of manufacturing and distribution plant and equipment. Neither of the plants will then, be able to operate at maximum efficiency and produce at the optimum level.

It must, however, be pointed out here that though the public utility concerns may not face direct competition from other undertakings, they cannot ignore competition of the substitutes for the demand which is met by them. In those markets where a public utility concern has an advantage over the other in respect of the suitability of its product or service as compared with another product or service which can meet the same demand, the prices charged may be higher than in those areas where it has a comparative disadvantages of his core strength.

6. **Franchise :** A franchise is in the nature of the grant of certain rights, privileges and immunities by the State Legislature or an agency authorized by the State. Since the public utility concerns are recognized as natural monopolies, a franchise is generally granted to protect them from competition from rival undertakings. The franchise can well be regarded as some kind of contract between the utility undertaking concerned and the granting authority. Under it, the utility concern may be permitted to function in a certain area, and make use of public property like roads of laying tramway lines, or water pipes, etc. The franchise may be perpetual or may be for long periods ranging from 25 to 50 years or even for short periods, say, ten years or so. Whatever the period of franchise, it is essential to ensure monopolistic position for these undertakings in the interests of operational efficiency.

7. **Public Control and Regulation :** Since a public utility undertaking has a natural tendency towards monopoly on various grounds already referred to here, it follows that suitable measures of public control and regulation of its activities should be provided for primarily with the object of saving it from the various abuses to which uncontrolled monopoly is open. The regulation may take the following forms :

(i) Regulation to ensure that the equipment is installed with least inconvenience to the public. The public authority concerned has, for example, to see that while laying pipes or cables underground there is the minimum possible dislocation of traffic.

(ii) Regulation of the quality of service in the interests of the safety of public health. To cite an example, the public authority responsible for regulation has to regulate the water supply in such a way that only well-chlorinated and wholesome water is supplied to the consumers.

(iii) Regulation of service charges, rates, prices and fares, etc, so that the monopolist power vested in the utility concern is not used to exploit the public by charging excessively for the services supplied to them.

On account of regulation by public authority, the public utilities are generally said to be clothed in public interest or affected by public interest. In most countries, the control and regulation of the public utilities rest with the public authority which owns the undertakings.

10.3 SPECIAL PROBLEMS

The peculiar nature of the public utility undertakings as distinguished from non-utility concerns is brought out quite amply by the economic characteristics discussed above. It follows from the above that these undertakings have some special problems connected with their organizations, working and management. Some of these problems are outlined here :

Size of Business : A business concern of the non-utility type generally enjoys a fair choice as to the size at which to start and the form of organization to be adopted. There is, of course, a minimum size for all types below which it is not economical to operate even in the beginning.

This minimum size varies from one line of business to another. In case of public utilities the minimum has to be a fairly large size. This is explained by the following factors :

- i) Generally, a single public utility undertaking is granted the franchise to cater to the essential needs of the people living in an area. This naturally requires a concern of a large size.
- ii) The whole of the plant has generally to be installed right in the beginning before the supply of a service can be started.
- iii) Public utility undertakings require huge sum of fixed capital which can be afforded only by large scale enterprises.

Choice of Site : The promoters of a public utility concern have little or no choice regarding the site where the plant is to be located and the roads on which pipelines, etc., have to be laid. Generally, the Local Authority managing the civic affairs of a local area fixes the site, etc. for the utility concerns and their plants and distribution networks. These concerns may, of course be given certain facilities and concessions for the erection of their plants.

Problem of Selling : The public utility undertakings have to grapple with comparatively fewer problems in the sphere of marketing of services. This is so because they do not have to face competition from rival suppliers. They can therefore, relate their price to the behaviour of cost without fear of losing business to rival competitors.

The utilities sell services and service-products which are entirely standardized with the result that there are no problems connected with salesmanship or brand advertising. It must, however, be recognized that public utilities mostly supply essential services to the premises of the consumers as in the case of water, electricity and gas supply. The public utilities must, therefore, provide for efficient and courteous repair and maintenance services. In some other undertakings, like transport services, the consumers come into direct touch with the operators quite frequently every day. It is necessary that in such cases, utmost courtesy is offered to the users of the service.

The general problems of credit collection so common in commercial concerns do not arise in the case of most public utility undertakings because sales are made generally on cash basis as in transport undertakings. There are therefore, no bad debts.

The absence of middlemen or intermediaries is another distinguishing feature of the commercial operation of public utilities. In most of the cases, sales are made directly by the undertakings to the users or consumers. In the sphere of electric supply, the development of hydroelectricity has made it possible for electricity to be generated on a large scale through a central grid system and supplied to various areas through their respective local authorities. The supply of electricity to Delhi from the Nangal grid through the Delhi Electricity Supply Undertaking is a case in point.

Though commercial advertising of the type employed by non-utility business concerns may not be unnecessary to sell the services and the service products of public utility concerns, they generally organise a strong and efficient informative wing which may bring the availability of the service to the notice of consumers. In the case of transport service, for example, such a wing will be unnecessary to keep the public acquainted with the frequency schedules and special services. This is unnecessary not only from the point of view of sound public relations but also on strictly economic ground, for a public utility concern must make an all-out bid to utilize idle capacity particularly during the off/peak periods.

10.4 PRICE POLICY

There are three broad aspects of the price policy of public utility undertakings :

- (i) promotional aspect;
- (ii) discrimination; and
- (iii) influence of social considerations.

Promotional Aspects : The promotional aspects is concerned with the adopt a of a price policy which will promote the demand for the services provided by a undertaking. Promoting demand is necessary to ensure the maximum utilisation of the total available capacity for it is only in that manner that the overhead costs (fixed expenses) can be spread over a large output to yield lower average fixed costs. If it achieves this end, the price per unit may be reduced for a larger consumption by any consumer

of service products or user of services. The city transport services generally offer season tickets at concessional rates to those who make a large number of journeys regularly and similarly, railways offer concessions of this type. But the promotional aspect is directed not only towards raising the total demand to the optimum level. It consist also in spreading demand evenly over peak periods and off-peak periods. This may be done by offering the services to off-peak users at very low prices.

Price Discrimination : Every public utility has come markets where the demand for its products is elastic because of the availability of substitute products, and some others where it is comparatively inelastic. The demand for bus service for tourist may be elastic but for the regular users like students and office-goers it is more or less inelastic. In a similar way, the demand for railway accommodation is elastic for those who go to hill resorts during summer, or if the railways increase their rates, they will travel by buses. But for people travelling long-distance journeys for business, the demand is inelatic. The public utility undertakings can then easily charge higher rates in the division of the market where the demand is inelastic and lower rates in the market of elastic demand. The hill concessions offered by railways during summer in India provide an example of this kind. In an ordinary business concern, goods may be transferred under such situation from the market to lower prices to that of higher prices. But the services of the public utility undertakings stand as a class apart because they cannot be transferred by users in one market to another. If higher rates are being charged for electricity supply to residential

premises and lower rates for factories, the factories cannot obviously sell their electricity to residential premises at a profit. This only means that a policy of price discrimination can be used quite conveniently by public utility concerns from the point of view of demand.

From the point of view of costs the generally accepted principle is that the charge per unit for each type of service must at least cover the marginal cost involved in rendering the service for otherwise, it will not be worthwhile meeting the demand. Since overhead count substantially in the cost structure of the public utility concerns, it is considered necessary that the price includes not only the marginal cost but covers the overheads which can be borne by the different markets according to the elasticity of demand in each one of them. This is known as the principle of charging 'what the market will bear'. Under this principle, 'the price in each market will cover the costs directly attributable to that market plus a contribution towards overheads based on elasticity of demand.

Social Considerations : Since public utilities are "affected with public interests" and touch the everyday life of the people at many points, considerations of social welfare quite often modify the purely economic price policy based on the other two enunciated above. The price policy of public utilities is then used as an instrument of social policies to grant price concessions to many classes of consumers as workers, or to the users with rather low incomes.

10.5 OWNERSHIP AND MANAGEMENT

One of the distinguishing characteristics of public utilities is the need for public regulation of these natural monopolies in the broader interests of the community in general. From this characteristic arises the question as to whether public utilities should be owned and managed by private business interests. Considering the amount of public interests involved in regular economical and fair supply of essential services, private enterprise appears to be much less suitable for the ownership and management of these enterprises than public enterprise. The point that remains to be decided then is as to what form public ownership of such enterprises can suitably take. As it is the public ownership and management can be secured through :

- (i) a Government department, or
- (ii) municipal councils, committees or corporations through special subcommittees, or
- (iii) public corporations under special statutes.

Department Management : Some public utilities are run as departments of the Government under the control and direction of ministries headed by politically responsible ministers. Railways and Posts and Telegraphs are examples of utilities run by the Central Government, while roadways (Haryana Roadways, Punjab Roadways, etc.) are run by departments of the State Governments.

The chief advantage of this form of ownership and management is that it ensures control by politically responsible officials. The finances are supplied by the Government through annual appropriations from the treasury and all revenues too, have to be paid into the treasury. If there is anything wrong with the management, it can be brought to the notice of Parliament which acts on behalf of and in the general interest of the public at large. But the departmental form is not suited to public utilities mainly because it lacks flexibility and cannot provide efficient, prompt, adequate and 'personal services to the public.

Municipal Control : A method employed in India and other countries for the management of public utilities is that of control by municipal committees, corporations or other local bodies. The local body concerned may appoint special subcommittees of its members to look after the public utility undertakings under its control. The subcommittees are assisted in their work by the permanent officials of the local bodies. In Delhi, for example, the Municipal Corporation of Delhi owns, manages and controls the public utility undertakings, including electricity supply (Delhi Electricity Supply Undertaking) and the water supply (Water Supply Department). There are elected committees responsible for their management.

Theoretically, municipal management of public utilities may appear to be justified because it provides the elected representatives of the local citizens to exercise direct control over their management on behalf of the electorate. The local problems arising from the supply of services can thus be readily taken up and dealt with. But, in practice, municipal

control suffers from some shortcomings. The councillors who get elected to the special committees may be of a low calibre so that they may lack the competence to deal with the diverse technical matters relating to the management of utilities. Political wrangling may only add to the damage done by the incompetence of the members. Quite often, therefore, utility undertakings under the control of local bodies prove unequal to the task of efficient supply of essential services to the people. The frequent power and water crises in Delhi bring out their shortcomings amply and clearly. Another limitation of Municipal operation and control of public utilities arises from the restriction of their area of operation to the local limits of a city or town. This may make the operation uneconomic for technological developments favour large-scale operation for reaping economies of various kinds.

Public Corporation : A public corporation is an autonomous corporate body set up under a special Act of Parliament that sets out its powers and functions as well as its jurisdiction over an activity or a particular area. Financially, it is independent of the Government and has its own share capital and Board of Directors. In its operations, it is very similar to the public limited company. But unlike a public limited company, it is accountable directly to the legislature before which its annual report and audited annual accounts are placed for approval. Thus it blends the efficiency and flexibility of private enterprise with control by the legislature in the broader interests of the community at large. These are precisely the requisites of success for public utility undertakings. Hence, the public

corporation can be commended as the most suitable form of organizations for the ownership and control of public utility undertakings.

10.6 SUMMARY

Public utilities are essential facilities of civic life. The life in modern civilisation heavily depends on certain services and conveniences which are indispensable. Organization engaged in public services and conveniences are referred to as public utilities undertakings. Supply of water, electricity, transport, gas etc. are main public utilities. In fact, the development of proper public utilities in a country requires huge capital investment. The price policy of such organization is normally guided by several considerations. But, mainly the promotional, discriminative and social considerations are taken as base for pricing policy of public utilities. The ownership of such organisations normally lies with public sector. Although, the private sector is also coming very fast for public utilities. Any civil society with all basic facilities in the modern world is called developed society and the country like India are moving very fast for the purpose.

10.7 KEYWORDS

Franchise: A franchise is in the nature of the grant of certain rights, privileges and immunities by the State Legislature or an agency authorized by the State. It is generally granted to protect them from competition from rival undertakings.

Public corporation: A public corporation is an autonomous corporate body set-up under a special Act of Parliament that sets out its powers and functions as well as its jurisdiction over an activity or a particular area. Financially, it is independent of the government and has its own share capital and board of directors.

Public utilities: The form of business organization established basically to arrange for the efficient and uninterrupted supply of such goods and services as are absolutely indispensable for a civilized community is referred to as a public utility organisation.

10.8 SELF ASSESSMENT QUESTIONS

1. Define public utilities. Discuss its economic characteristics with examples.
2. Explain and illustrate the price policy of public utilities in India.
3. Discuss ownership and management pattern of public utilities in India in detail.

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Subject : Business Flow System

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Course Code : MCA-104

Vetter : Dr. H. Bansal

Lesson : 11

NATURE AND PRINCIPLES OF MANAGEMENT

STRUCTURE

- 11.0 Objectives
- 11.1 Introduction
- 11.2 Definition of Management
- 11.3 Characteristics of Management
- 11.4 Importance of Management
- 11.5 Principles of Management
- 11.6 Scientific Management
- 11.7 Principles of Scientific Management
- 11.8 Summary
- 11.9 Keywords
- 11.10 Self Assessment Questions
- 11.11 References/Suggested Readings

11.0 OBJECTIVES

After reading this lesson, you should be able to-

- understand the meaning, definition and characteristics of management;
- explain principles of management;
- describe importance of management; and
- understand meaning and principles of scientific management.

11.1 INTRODUCTION

A business develops in course of time with complexities. With increasing complexities managing the business has become a difficult task. The need

of existence of management has increased tremendously. Management is essential not only for business concerns but also Banks, Schools, Colleges, Hospitals, Hotels, Religious bodies, charitable trusts etc. Every business unit has some objectives of its own. These objectives can be achieved with the coordinated efforts of several personnel. The work of a number of persons are properly co-ordinated to achieve the objectives through the process of management is not a matter of pressing a button, pulling a lever, issuing orders, scanning profit and loss statements, promulgating rules and regulations. Rather it is the power to determine what shall happen to the personalities and happiness of entire people, the power to shape the destiny of a nation and of all the nations which make up the world." Peter F. Drucker has stated in his famous book "The Practice of Management" that, "the emergence of management as an essential, a distinct and leading social institution is a pivotal event in social history. Rarely in human history has a new institution proved indispensable so quickly and even less often as a new institution arrived with so little opposition, so little disturbance and so little controversy."

11.2 DEFINITION OF MANAGEMENT

Management is the art of getting things done by a group of people with the effective utilization of available resources. An individual cannot be treated as a managing body running any organization. A minimum of two persons are essential to form a management. These persons perform the functions in order to achieve the objectives of an organization.

Peter F. Drucker defines, "management is an organ; organs can be described and defined only through their functions".

According to Terry, "Management is not people; it is an activity like walking, reading, swimming or running. People who perform Management can be designated as members, members of Management or executive leaders."

Ralph C. Davis has defined Management as, "Management is the function of executive leadership anywhere."

According to Mc Farland, "Management is defined for conceptual, theoretical and analytical purposes as that process by which managers create, direct, maintain and operate purposive organization through systematic, co-ordinated co-operative human effort."

Henry Fayol, "To manage is to forecast and plan, to organise, to compound, to co-ordinate and to control."

Harold Koontz says, "Management is the art of getting things done through and within formally organized group."

William Spriegal, "Management is that function of an enterprise which concerns itself with direction and control of the various activities to attain business objectives. Management is essentially an executive function; it deals with the active direction of the human effort."

Kimball and Kimball, "Management embraces all duties and functions that pertain to the initiation of an enterprise, its financing, the establishment of all major policies, the provision of all necessary equipment, the outlining of the general form of organization under which the enterprise is to operate and the selection of the principal officers."

Sir Charles Reynold, "Management is the process of getting things done through the agency of a community. The functions of management are the handling of community with a view of fulfilling the purposes for which it exists."

E.F.L. Brech, "Management is concerned with seeing that the job gets done, its tasks all centre on planning and guiding the operations that are going on in the enterprise."

Koontz and O'Donnel, "Management is the creation and maintenance of an internal environment in an enterprise where individuals, working in groups, can perform efficiently and effectively toward the attainment of group goals. It is the art of getting the work done through and with people in formally organised groups."

Dr. James Lundy, "Management is principally a task of planning, co-ordinating, motivating and controlling the efforts of other towards a specific objective. It involves the combining of the traditional factors of production land, labour, capital in an optimum manner, paying due attention, of course, to the particular goals of the organisation."

Wheeler, "Management is centered in the administrators or managers of the firm who integrate men, material and money into an effective operating limit."

J.N. Schulze, "Management is the force which leads, guides and directs an organisation in the accomplishment of a pre-determined object."

Oliver Scheldon, "Management proper is the function in industry concerned in the execution of policy, within the limits set up by the administration and the employment of the organisation for the particular objectives set before it."

Keith and Gubellini, "Management is the force that integrates men and physical plant into an effective operating unit."

Newman, Summer and Warren, "The job of Management is to make co-operative endeavour to function properly. A manager is one who gets things done by working with people and other resources in order to reach an objective."

G.E. Milward, "Management is the process and the agency through which the execution of policy is planned and supervised."

Ordway Tead, "Management is the process and agency which directs and guides the operations of an organisation in the realising of established aims."

Management is the group of activities which draft plans, prepare policies and arrange men, money, machine and materials required to achieve the objectives. The above definitions reveal that management is the activity of man who struggles for better living in the complex and competitive world. Besides, the management gives satisfaction to and rewards those who are engaged in the operation and ensuring an excellent performance. In other words, management is the process consisting of the functions of planning, organising, staffing, directing and controlling the operations to achieve specified objectives.

11.3 CHARACTERISTICS OF MANAGEMENT

From a critical analysis of the above definitions, the following characteristics of management are drawn here under :

1. Art as well as science

Management is both an art and a science. Management is an art in the sense of possessing of managing skill by a person. In another sense, management is the science because of developing certain principles or laws which are applicable in a place where a group of activities are co-ordinated.

2. Management is an activity

Management is a process or activity relating to the effective utilisation of available resources for production. The term 'resources' includes men, money, materials and machine in the organisation.

3. Management is a continuous process

The process of management mainly consists of planning, organising, directing and controlling the resources. The resources (men and money) of an organisation should be used to the best advantage of the organisation and the objectives achieved. The management function of any one alone cannot produce any

results in the absence of any other basic functions of management. So, management is a continuous process.

4. Management achieving pre-determined objectives

The objectives of an organisation are clearly laid down. Every managerial activity results in the achievement of objectives fixed well in advance.

5. Organised activities

Management is a group of organised activities. A group is formed not only in Public Limited Company but also in ordinary club. All the organisations have their own objectives. These objectives will be achieved by a group of persons. These persons' activities should be organised in a systematic way to achieve the objectives. The objectives cannot be achieved without any organised activities.

6. Management is a factor of production

The factors of production includes land, labour, capital and entrepreneur. Here, land refers to where production is undertaken. Labour refers to the paid employees of the organisation who are working at different levels as skilled, unskilled, semi-skilled, manager, supervisor and the like. Capital refers to the working capital as in the form of cash, raw materials and finished goods and fixed capital as in the form of plant facilities and production facilities. These land, labour and capital could not realise the organisation's goals on their own. The organisation goals are achieved only when these are effectively co-ordinated by the entrepreneur. An individual can do such type of job in the case of small business. In the case of big sized business units, co-ordination job is done by the management. So, management is also treated as one of the factors of production. According to Peter F. Drucker, "Whatever rapid economic and social development took place after World war II, it occurred as a result of systematic and purposeful work of developing managers and management. Development is a matter of human energies rather than of economic

wealth and the generation of human energies is the task of management. Management is mover and development is a consequence."

7. Management as a system of authority

A system may be defined as a set of component parts working as a whole. Authority may be defined as a right to command others for getting a particular course of organizational work done.

Individuals are the foundation stones of the management. An individual has some goals as a member of the organisation. There may be a conflict between his own goals and the management's expectations from that individual. Such a conflict is resolved by the management by integrating individual goals with organizational expectations.

Authority is vested in many persons to take decisions and influence the behaviour of the subordinates. The very purpose of using the authority is to check and control the behaviour of the subordinates. The sources of authority rest with superiors as given in the organisation chart and social norms. The utilisation of authority is based on the personality factors of the user and the behaviour of a person over whom it is used.

8. Management is a discipline

The boundaries of management are not exact as those of any other physical science. It may be increased by the continuous discovery of many more aspects of business enterprise. So, the management as a discipline is also increased in the same manner.

9. Management is a purposeful activity

Management is concerned with achievement of objectives of an organisation. These objectives are achieved through the functions of planning,

organising, staffing, directing, controlling and decision-making. The organizational objectives are clearly defined and explained to every employee.

10. Management is a distinct entity

Management is distinct from its functional activities. The functions have the nature of "doing" but the management has the nature of "how to get things done." A manager requires some amount of skill and knowledge to get work done.

11. Management aims at maximizing profit

The available resources are properly utilized to get desired results. The results should be maximizing profit or increasing profit by the economic function of a manager.

12. Decision-making

There are number of decisions taken by the management everyday. Decision-making arises only when there is availability of alternative courses of action. If there is only one course of action, need for decision-making does not arise. The quality of decision taken by the manager determines the organisations' performance. The success or failure of an organisation depends upon the degree of right decision taken by the manager.

13. Management is a profession

Management is a profession because it possesses the qualities of a profession. A fund of knowledge is imparted and transferred in profession and the same is followed by management. The established principles of management are applied in practice.

14. Universal application

The principles and practices of management are applicable not to any

particular industry alone but applicable to every type of industry. The practice of management is different from one organisation to another according to their nature.

15. Management is getting things done

A manager does not actually perform the work but he gets things done by others. According to Koontz and O'Donnel, "management is the art of getting things done through and with people in formally organised groups."

16. Management as class or a team

A class may be defined as a group of people having homogenous characteristics to achieve common objectives. Engineers and Doctors are grouped as class in a society. Each and every doctor has the same objectives in life. Just like engineers and doctors, the management people have got similar aspirations to achieve corporate objectives.

17. Management as career

Nowadays, management is developed as a career focussed on certain specialization. Financial Management, Cash Management, Portfolio Management, Marketing Management, Personnel Management, Industrial Management and Business Management are some of the specialisations of management. Specialists are appointed in the key posts of top management.

18. Direction and control

A manager can direct his subordinates in the performance of a work and control them whenever necessary. If the available resources are not utilized properly by him, he fails to achieve the corporate objectives in the absence of direction and control. Generally, the direction and control deals with the activities of human effort.

19. Dynamic

The management is not static. In the fast developing business world, new techniques are developed and adopted by the management. Management is changed according to the social change. The social change is the result of the changing business world.

20. Management is needed at all levels

The functions of management are common to all levels of organisation. The top executives perform the functions of planning, organising, directing, controlling and decision-making. The same functions are also performed at the lower level also.

21. Leadership quality

Leadership quality is developed in the persons who are working at the top level of management. According to R.C. Davis, "Management is the function of executive leadership everywhere."

11.4 IMPORTANCE OF MANAGEMENT

Management is a must for every enterprise. The existence of management ensures proper functioning of an enterprise. Management plans the activities to achieve the objectives and utilise the available resources at minimum cost.

Every business needs a direction. This direction is given by the management. The resources of production are converted into production. The conversion will remain as resources in the absence of management. The conversion process is performed through the co-ordination of management. The significance or importance of management is briefly explained below:

1. Management meet the challenge of change

In the modern business world, there are frequent changes. The changes place the business in a dangerous position. Only an efficient management can save the business from the dangers brought in by the challenges.

2. Accomplishment of group goals

The achievement of objectives of business depends upon three factors- proper planning of available resources, adjusting possibility of business unit with existing business environment, and the quality of decision taken and control made by the business unit. It is management that takes care of these factors and accomplishes group goals.

3. Effective utilization of resources

There are eight 'M's in the business. These are said to be man, money, materials, machines, methods, motivation, markets and management. Management is the top most of all 'M's. Management has control over other remaining 'M's.

4. Effective functioning of business

Ability, experience, mutual understanding, co-ordination, motivation and supervision are some of the factors responsible for the effective functioning of business. Management ensures that the abilities of workers are properly used and co-operation is obtained with the help of mutual understating. Besides, management tries to know the expectation of workers and the expectation are fulfilled through motivation techniques.

5. Resource development

Effective management is the boat of any developed business. The resources of the business may be identified and developed by the management. The term 'resources' includes men, money, material and machines.

6. Sound organisation structure

Management lays down the foundation for sound organisation structure. Sound organisation structure clearly defines the authority and responsibility relationship—who is responsible to whom, who will command whom and who is responsible for what. Care is taken in appointing qualified persons to the right job by the management.

7. Management directs the organisation

The human mind directs and controls the functioning of human body. Similarly, the management directs and controls the functioning of an organisation.

8. Integrates various interests

Each person has his own interest. These interests are different in nature. Management takes steps to integrate various interests to achieve the objectives of an organisation.

9. Stability

The fluctuations of business are stabilized by the management. The fluctuations of business are caused by changing policy of the government, pressures on the part of competitors and changing preference of customers. The efficient management can run the business as per the policy framed by the government, face the competitors in the market and produce the articles as per the preferences of customers.

10. Innovation

New ideas are developed by the management and implemented in the organisation. Better performance is achieved through new ideas.

11. Co-ordination and team-spirit

All the activities of business are grouped departmentwise. Management co-ordinates the activities of different departments and establishes team-spirit to achieve the objectives.

12. Tackling problems

Good management acts as a friend or a guide of workers while tackling problems. When workers develop over confidence as regards to solve problems for effective performance of a job, they may fail in tackling the problems efficiently. Here the role of management comes into action.

13. A tool for personality development

Management gives direction to workers for effective performance of a job. Besides, new methods or techniques are taught to workers. The training facilities are arranged by the management. In this way, management is a tool to develop the personality of workers to enhance their efficiency.

11.5 PRINCIPLES OF MANAGEMENT

Although many authorities in the field of management have evolved certain principles of management but the set of fourteen principles given by Henry Fayol has set forth the principles of management on the basis of his own expertise and experience in the field of management. These principles are discussed here under :

1. Division of work

Division of work transforms, a man into a specialist. The reason is that division of work helps to specialise is an activity which increases the output with perfection. Besides, it avoids waste of time. According to Henry Fayol, division of work is applied to both technical and managerial kinds of work.

2. Authority and responsibility

Management is getting things done through others. When a superior gives direction to his subordinates to perform the job, he may exercise his authority. The post he holds invests him with this authority. Authority is closely connected with responsibility. Responsibility is shouldered whenever the authority is exercised. Responsibility is essential to perform a job correctly.

3. Discipline

According to Koontz and O'Donnell, "Discipline is the respect for agreements which are directed at achieving obedience, application, energy and the outward marks of respect." According to Henry Fayol, discipline is essential at all levels of management. Discipline is obtained through judicial application of penalties.

4. Unity of command

A subordinate has only one superior. If not so, the subordinate can not perform any job perfectly. In other words, each subordinate is responsible to only one superior.

5. Unity of direction

The business activities are grouped on anyone of the base, normally on functional basis. The activities of a group are assigned to a person who is said to be a manager. This manager is expected to look after all the activities of a particular group.

6. Subordination of individual interest to group interest

An individual has his own interest. At the same time, the organisation has its own interest. Here, the interest of an organisation is termed as group interest. Henry Fayol expected the reconciliation of the individual interest with group interest. In no way, the individual interest should dominate the group interest.

7. Remuneration of personal

According to Henry Fayol, employees should be given fair and reliable remuneration. The employees should get satisfaction out of their wages. The wages are determined on the basis of the work done by the employees and the wages payable should be similar to those of other companies. Besides, the payment of wages should be made without any delay.

8. Centralization

Everything increases the importance of superior's role in centralization, while everything decreases the importance of superior's role in decentralization. In small firms, authority is centralized. In large firms authority is disentangled. But, the centralization or decentralization of authority depends upon the personal character of the superior, his morality, reliability of resourcefulness and the like.

9. Scalar Chain

According to Henry Fayol, "Scalar chain is chain of superiors ranging from the ultimate authority to the lowest ranks." The communication flows from top to bottom. For example, A is the superior and has three subordinates in the order B, C and D. If A wants to communicate anything to D it should be passed Via B and C., likewise if D wants to communicate anything to A, it should be passed via C and B. This is called scalar chain.

10. Order

The principle of right place for everything and for everyone should be followed the management. It is applied to both material and men. The material should be kept in order and at the place where it is necessary. The personnel are selected scientifically and assigned duties according to their qualifications and abilities.

11. Equity

Equity refers to a combination of fairness, kindness and justice. All the employees of the organisation are treated equally by the managers. The application of equity requires goodness and experience of managers. Besides, it requires loyalty and devotion from subordinates.

12. Stability of tenure of personnel

The security of job is an essential one. Insecurity of job results in the higher labour turnover. It increases the administrative expenses. Unless and otherwise an employee has committed a mistake, no employee should be removed from service. The development of any organisation depends solely on the sincerity of labour.

13. Initiative

A manager should have the executing initiative. It will have psychological effect over the subordinates. The subordinates are free to express their views or opinions in the execution of the work. Henry Fayol suggests that managers can take decisions after getting suggestions from the subordinates.

14. Esprit De Corps

This means union is strength or team spirit. All the employees of the organisation are put together as a team in order to achieve the objectives of the organisation. If there is any misunderstanding or difference of opinions or distrust the management should take corrective steps to remove them. The management should not follow the policy of divide and rule.

11.6 SCIENTIFIC MANAGEMENT

In the 18th century, the production was affected by industrial revolution, when the management people wanted to increase their production. Their ambitions were fulfilled by the invention of the concept of Scientific Management by F.W.

Taylor in the 19th century. F.W. Taylor is the first person to find the concept of Scientific Management and developed it so, he is called as the father of Scientific Management.

According to F.W. Taylor, Scientific Management consists of a certain Philosophy of scientific selection and training of right workers to right job, providing adequate working conditions, providing a system of monetary incentives and supervisors. The workers are selected scientifically and training is provided to both new and existing workers. The workers are placed according to their qualifications and experience. The effective performance of any work depends upon physical working conditions, lighting, ventilation, rest rooms, rest periods, drinking water, canteen, recreation, sanitation and the like. The system of monetary incentives should motivate the workers to work well. Management and supervisors should accept responsibility for planning, scheduling, guiding and controlling. It means that planning and execution are different functions.

F.W. Taylor defined Scientific Management as "the substitution of exact scientific investigations and knowledge for the old individual judgment or opinion; either of the workmen or the boss, in all matters relating to the work done in the establishment."

F.W. Taylor firmly believed that the objective of management should be the maximum prosperity for the employer and maximum prosperity to each employee. The prosperity for the employer means lower costs but higher returns. Maximum prosperity to the employee means fair as well as higher wages. These can be achieved through the adoption of Scientific Management.

11.7 PRINCIPLES OF SCIENTIFIC MANAGEMENT

F.W. Taylor has given the principles of Scientific Management which are briefly explained below:

1. Science not rule of thumb

It means the replacement of old method of doing work scientifically. The nature of work performed by each worker should be clearly determined. It includes the allotment of fair work to each worker, standardization of work, adoption of differential piece rate of payment system and the like.

2. Harmony in group action

F.W. Taylor has emphasized peace and friendship in group action. In other words, dissatisfaction of any worker is to be avoided in the group action. The dissatisfaction is eliminated through scientific selection, training and placing of workers.

3. Co-operation

There should be a co-operation between management and workers. Workers should help the management to get higher profits, better quality products and lower cost of production. Management should give fair wages to workers, recognize the performance of work and acknowledge the indispensability of workers in raising productivity. Then, better co-operation will be achieved. According to Taylor, substitution of war for peace, hearty and brotherly co-operation for discontentment and strife, replacement of suspicious watchfulness with mutual confidence of becoming friends instead of enemies result in co-operation. Mutual understanding and change in thinking are the factors necessary for co-operation.

4. Maximum output

Maximum output is achieved through division of work and assumption of responsibility by management and workers jointly. Maximum output results in the increasing profit to the management and wages and bonus to the workers. Management should provide standard materials, tools and working conditions to perform the work economically and efficiently.

5. Improvement of workers

Under Scientific Management, all the workers should be given opportunity to improve to the fullest, extent possible. It is necessary for the development of company. Workers are scientifically selected and provided with the job training, so, the management should find out the physical, educational and psychological requirements of each job and find suitable person to each job. Systematic training can shape the workers to the job assigned to them.

11.8 SUMMARY

Management is getting the things done through the people with all efficiency and effectiveness. Now-a-days, the organisations are surrounded by many complexities and therefore, managing an organisation successfully has become a very difficult task. The managers are required to make an extensive use of the most widely accepted principles of management because without predertermined principles and policies, the organisations can not be managed efficiently and effectively in this era of global competition.

11.9 KEYWORDS

Discipline: It is the respect for agreements which are directed at achieving obedience, application, energy and the outward marks of respect. It is essential at all level of management.

Equity: It refers to a combination of fairness, kindness and justice.

Management: It is the art of getting things done through and with others in formally organized groups.

Scalar chain: It is the chain of superiors ranging from the ultimate authority to the lowest ranks.

Scientific management: The substitution of exact scientific investigations and knowledge for the old individual judgement or opinion; either of the workmen or the boss, in all matters relating to the work done in the establishment.

System: It may be defined as a set of components parts working as a whole.

Unity of direction: The activities of a group are assigned to a person who is said to be a manager. This manager is expected to look after all the activities of a particular group.

11.10 SELF ASSESSMENT QUESTIONS

1. Discuss and illustrate the meaning, definition and characteristics of management in modern organisations.
2. What is management ? Explain the principles of management with suitable illustrations.

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Subject : Business Flow System

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Course Code : MCA-104

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Lesson : 12

FUNCTIONS OF MANAGEMENT

STRUCTURE

- 12.0 Objectives
- 12.1 Introduction
- 12.2 Planning
- 12.3 Organising
- 12.4 Directing
- 12.5 Controlling
- 12.6 Coordination
- 12.7 Role of Management Functions in Decision-making
- 12.8 Summary
- 12.9 Keywords
- 12.10 Self Assessment Questions
- 12.11 References/Suggested Readings

12.0 OBJECTIVES

After reading this lesson, you should be able to-

- understand and describe functions of management;
- explain the role of each function in modern business organisations;
- know the steps involved in decision-making process.

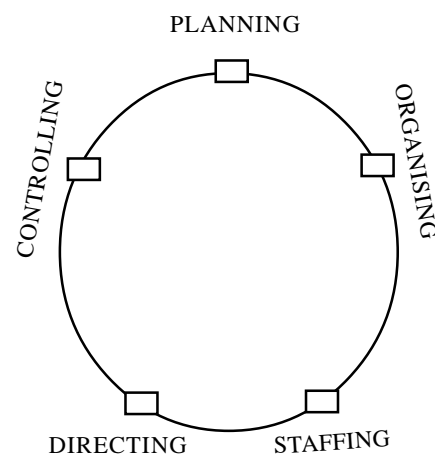
12.1 INTRODUCTION

Among those who tried to analyse the functions of management, Henri Fayol's name is simply the most outstanding. It has already been noted in the last

chapter that Fayol, after very long years of experience as the principal executive of his giant-sized concern, enunciated general principles of management in his work *L'Administration Industrielle et Generale* (Industrial and General Administration). Fayol noted that managerial activity consisted mainly in (i) forecasting and planning (described by the French word *prevoyance*), (ii) organising, (iii) commanding, (iv) co-ordinating, and (v) controlling. Fayol's approach to the functions of management has been most widely accepted and practically all authorities on management have based their description of such functions on it.

Gullick gave a formula word to indicate the principal functions of management. According to him, management functions may be indicated by, the word **PODSCORB** such that 'P' stands for 'Planning, 'O' for 'Organising, 'D' for 'Directing, 'S' for Staffing 'CO' for 'Co-ordination, 'R' for 'Reporting' and 'B' for 'Budgeting'. Of these, Reporting is covered by the controlling function. Budgeting represents planning and budgets are used also for controlling. As such, the Budgeting function is incorporated in the functions of Planning and Controlling. Some authors notably Ernest Dale cite "Innovating" as a distinct and separate function of management. Their plea is that management anywhere and everywhere does involve the planning and introduction of new systems, procedures, methods, techniques and services and all these could be well described by the term innovating.

While it is good to emphasize the need for innovation in management, it will be realised that the need for innovation usually arises from review of the existing methods, etc. The planning of change is a part of the planning function. Taking everything into account, the principal functions of management in most of the business and non-business enterprises are :



The Management Process

(i) Planning including (a) forecasting, and (b) formulation of objectives, policies, programmes, schedules, procedures, and budgets.

(ii) Organising including (a) identification and grouping of work activities, (b) definition and delegation of responsibility and authority, and (c) establishment of authority-responsibility relationships.

(iii) **Staffing** including (a) selection, (b) communication, (c) participation, (d) appraisal, (e) counselling, (f) training, (g) compensation, (h) dismissal, etc.

(iv) Directing including (a) decision-making, (b) guiding, (c) supervising, (d) communication, and (e) motivating.

(v) Controlling including (a) laying down performance standards, (b) measurement, (c) interpretation, and (d) corrective action.

Organic Functions of Management. William M. Fox describes the three functions of planning, organising and controlling as the organic functions of management. An organic function, according to him, is a function which is invariably basic to, and inherent in, managerial activity whenever it is performed. In other words, a manager does have to perform these functions in every situation where he has to manage men and work towards an objective or objectives. The other functions, then become the sub-functions of managers and may be classified as organic functions as under :-

Planning

Organising

Controlling (the work of others)

(a) Staffing

(a) Delegating

(b) Training

(b) Directing

(c) Motivating

(d) Co-ordinating

(e) Evaluating

(f) Correlating

Interaction of Functions and the Management Process. If management is accepted as the process of planning, organising and controlling human activity towards definite goals, it may give an impression that the three organic functions of management are independent compartments and the manager first plans, then organises and finally performs the function of controlling. But, a little thought will show that this is an oversimplification of the real-life situation. "In reality, management is a continuous operation or process involving the interaction of all functions. When a manager plans for planning, he organises for planning and controls for planning. Likewise, when he performs the function of organising, he plans for organising, organises for organising and controls for organising. Also, when he is to control, he has to plan for controlling, organise for controlling and control for controlling. The purpose of separating the functions of management is to ensure that sufficient attention will be paid to each one of them in studying them. Otherwise, in a manager's life, they are all intertwined and are being performed simultaneously and repeatedly."

Managerial Functions in relation to Business Functions. A manager manages by planning, organising, directing and controlling. These functions involve reflection, analysis and intellectual judgments in the form of decisions at every step. But this should not create the impression that the management function is one of fruitless churning of mind and thoughts. In fact, a manager will ultimately be judged by the results achieved by him. It is, therefore, important to underline how the managerial functions are related to the various functions involved in any function or other kind of activity.

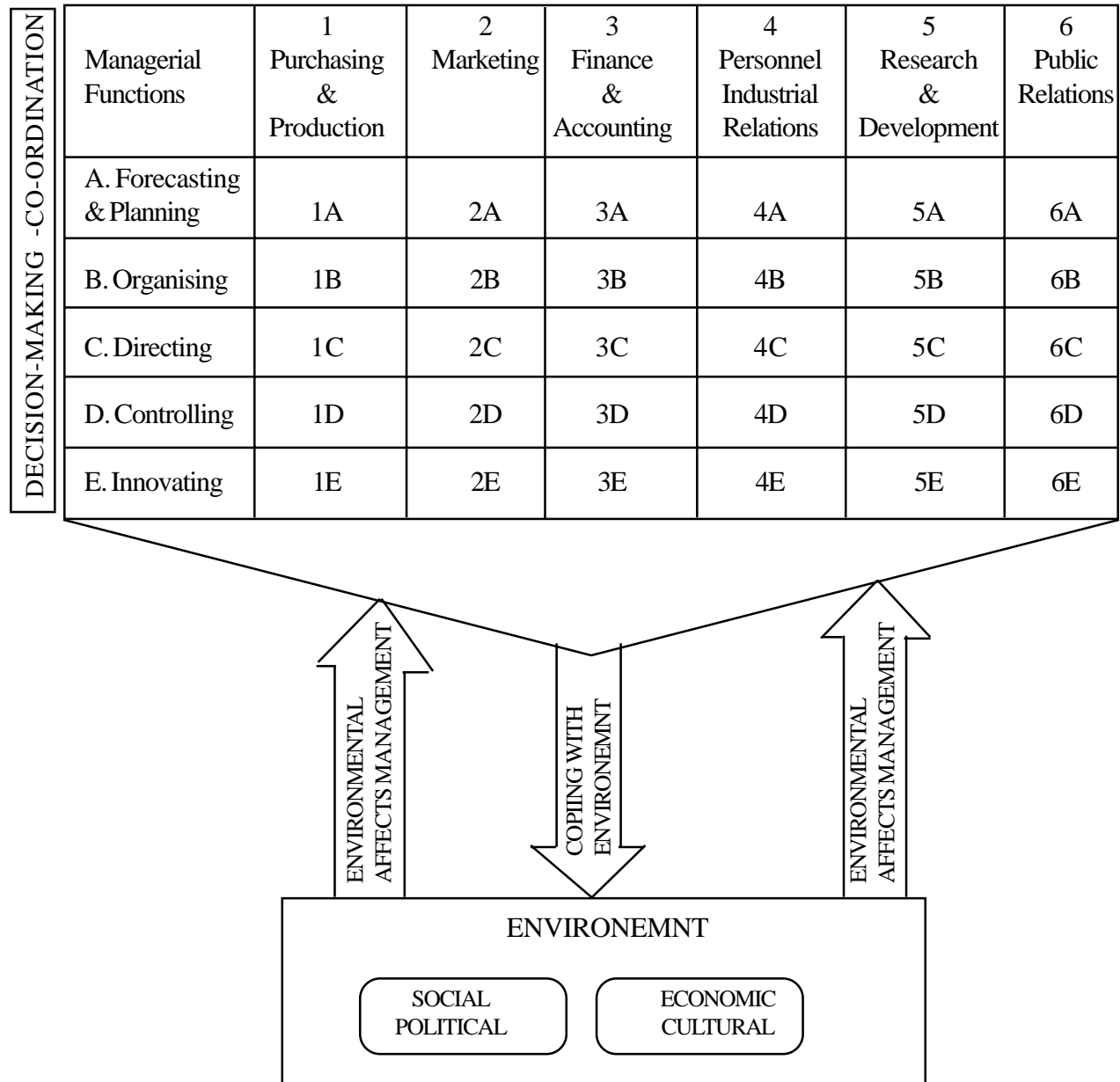
The most important characteristic of the managerial functions is that have universal applicability. Whether it is an industrial enterprise or a bank or a marketing organisation or a hospital or a college or a club, its management (or administration)

will call for the same functions of planning, organising, directing and controlling to be performed. By controlling through review and evaluation, a manager will have to innovate by devising and introducing new approaches, methods and techniques so to change and improve the other functions of planning, etc. In performing any of the various function of management, he will have to exercise the essential functions of decision-making and Co-ordination.

While the managerial functions will be the same for all types of organisations and at all levels in any organisation, the business functions (or activities) will vary according to the outputs (results) desired to be achieved and inputs (resources) required to be used. For example, in a manufacturing enterprise, the business functions will include Purchasing, Production, Marketing, Finance and Accounting, Personnel and industrial Relations, Research and Development, Public Relations, etc. In a trading organisation, business functions will be Buying and Merchandising, Finance and Accounting, Establishment, Sales, Security and General Administration. The business functions of college will comprise Admissions, Teaching and Curriculum Development, Accounting and Funds Management, Staff and Establishment, Hostel-Residence and Messing, Property Maintenance and Expansion, etc. In short, the business functions of an organisation will depend upon the business carried on by it.

The management of any business or other organised activity will involve the performance of managerial functions in relation to each of the business functions so as to contribute toward the overall objectives of the organisation. Since the business or the other activity in question has to be carried out in a given environment consisting of the social, economic, political and cultural factors bearing on it, the management of a business has to be geared to its environment.

The above approach, when applied to an industrial enterprise, can be presented in the form of the following matrix chart :



The above marris can be used for analysing and understanding management function and pinpointing problem areas. To illustrate the point, the function of planning marketing is represented by box 2A; the function of organising purchasing is represented by 1B; and so forth. If we wish to pinpoint a management problem, we

can determine the main business function to which it pertains and relate it to the major managerial function involved. It is similar to the location of a place on the map of a country by marking the point where the line of its latitude crosses the line of its longitude. To take an example, suppose a business enterprise is unable to meet the demand for its product because of stock-outs with the dealers. The problem may be located in the area of marketing. Further analysis may reveal that the problem has arisen mainly because of poor forecasting and planning. The problem area for thought and action will, then, be 2A.

The above matrix chart may also be viewed as a kind of outline map of management functions where the contour lines are given in the form of managerial functions which remain the same for all activities, but the business functions like places and regions have to be filled out depending upon the type of organisation and the nature of its work and objectives.

12.2 PLANNING

Planning is deciding in advance what is to be done. It is the determination of a course of action to achieve a desired result. A plan is, then, a projected course of action. All planning involves anticipation of the future course of events and, therefore, bears an element of uncertainty in respect of the future course. Fayol pointed out, "The plan of action is, at one and the same time, the result envisaged, the line of action to be followed the stages to go through, and methods to use. It is a kind of future picture wherein proximate events are outlined with some distinctness, whilst temoteevents appear progressively less distinct." Planning is a mental process requiring the use of intellectual facilities, imagination, foresight, sound judgement, etc.

Planning involves (a) problem-solving (identification of alternatives), and (b) decision-making (selection from alternatives). In planning, a manager searches for

the alternative courses open to him and then selects from these alternatives to determine general and specific objectives and detailed means for achieving them. Some writers on management starting with F.W. Taylor, the father of Scientific Management Movement, are of the view that planning should be separated from performance but it is recognised by most people that planning and responsibility for planning cannot be completely separated from managerial performance because all managers plan, whether they are at the top, middle, or bottom of the organisation structure. The function of planning incorporates forecasting as it is only through anticipation of future that a manager can decide upon the future course of action.

12.3 ORGANISING

The function of organising is the creation of structure of duties and functions for the attainment of the objectives of the concern. The organisation structure consists of relationships at all levels of authority. Urwick defines organisation as "determining what activities are necessary to any purpose (or plan) and arranging them in groups which may be assigned to individuals."

It is an important function of management to organise the enterprise by grouping the activities necessary to carry out the plans into administrative units, and defining the relationships among the executives and workers in such units. Organisation deals with the human and material factors in business. Mostly the human material is given and is the most serious headache of an organiser. He takes the short and easy way of trying to mould his organisation according to the fancies and peculiarities of the men under him. But this is not proper. An outline of the organisation must be thought out beforehand, and the organiser should try to fit men to his ideas, rather than ideas to men. He may have to make deviations here and there but such deviations should be temporary, to be given up as soon as an opportunity comes. Fayol says in this connection, "See that human and material organisations are suitable" and "ensure material and human order."

12.4 DIRECTING

In practice, management is essentially the art and process of getting things done. The managers have, therefore, the responsibility not only of planning and organising the business operations but they are equally responsible for guiding and supervising the subordinates. This is the managerial function of direction. The function of direction has three essential components :

- (i) issuing of orders and instructions;
- (ii) guiding and teaching the subordinates in the proper methods of work; and
- (iii) supervising the subordinates to ensure that their performance conforms to the plans.

Directing was identified by Henri Fayol as the function of command. In modern times, the following aspects of this important managerial function are usually identified:

- (i) Leadership,
- (ii) Communication,
- (iii) Motivation, and
- (iv) Supervision.

Leadership. The function of direction involves the exercise of the functions of leadership. Leadership, according to Chester I. Barnard, "is the quality of the behaviour of individuals whereby they guide people or their activities in organised effort." A leader has the function of interpreting the objectives of group effort and guiding or leading the group as a team towards the realisation of these objects. Managers at all levels act as leaders because they have subordinates (followers) whose efforts have to be channelised in a definite direction. As leaders, they have

not only to show the way but also to lead the group towards it. In doing this, the manager leading the whole or a part of the organisation has to set an example to his followers. He has to establish both by conduct and expression the community of interests which prompts people in a group to work together for certain given ends.

Communication. The process of leadership as a part of the function of direction requires effective communication between the leader and the led as also between one subordinate and the other. Simply stated, the process of communication is the passing of information and understanding. According to Louis Allen, "Communication is the sum of all things one person does when he wants to create understanding in the mind of another. It involves a systematic and continuous process of telling, listening and understanding." It is the responsibility of management to establish and maintain channels whereby it can convey its own thinking and policies to the subordinates and can receive their reactions and an account of their problems.

Motivation. Motivation means the creation among the personnel the willingness to work and co-operate for the accomplishment of common objectives. A manager, must motivate people to highest productivity. All administrative action loses its point unless the members of the enterprise are willing to contribute their effort for the fulfillment of their assigned tasks. The role of motivation is to develop and intensify a desire in every member of the organisation to work effectively in his position. The task of creating effective motivation calls for a proper appreciation of human behaviour. Management has to rely on the insights provided by sociologists, psychologists, and social anthropologists for such appreciation.

The management must realise that individual reactions to particular instruction or measure will depend upon such factors as (i) the individual's needs and characteristics, (ii) his emotional and temperamental make-up, (iii) the pattern of his beliefs, and (v) the social organisation (say, the informal group) of which he is a part. Any attempt to motivate people must take these factors into account.

Supervision. Literally supervision means overseeing (super-above or over, and vision=sight or seeing). In directing his subordinates, the managers have generally to exercise supervision over them in the sense that they have to personally watch, direct and control their performance. In doing this, they have to plan the work of their subordinates, give them directions and instructions, guide them, and what is most important, exercise leadership in gearing the subordinates together into a team. He has to listen to their grievances and complaints and maintain discipline and work standards. Thus, the function of supervision has two broad aspects to it : (a) technical guidance and direction, and (b) human relations and leadership. This function assumes greater importance at the lower levels of management as compared to the top or higher levels.

12.5 CONTROLLING

Controlling is ordinarily understood as giving of orders or restricting. But properly speaking, it means to guide something or somebody in the direction in which it is intended to go. In terms of managerial functions, control consists of the steps taken to ensure that the performance of the organisation conforms to the plans. A manager is responsible for controlling the work for which he is accountable.

The managerial function of control is inseparably connected with the function of planning. Unless the management is able to fix in clear and unambiguous terms the objectives of the organisation and can chart out a clear and realistic course of action for their attainment, effective control is almost impossible. The most notable feature of the process of control is that it is forward-looking or futuristic. A manager cannot, for obvious reasons, control or do anything about past. He can study the past, note the pitfalls and avoid them in future with a view to preventing their recurrence.

12.6 CO-ORDINATION

That there should be specialization of functions in a business concern goes without saying. Along with specialization there must be conscious effort on the part

of management to see that all activities, carried on by experts and different departments, should contribute to the achievement of the objective of the business. All activities not essential to the main objectives, howsoever attractive, must be eliminated. It's important to ensure that the different departments do not work at cross-purposes. The danger is too great. Salesmen are never tired of pointing out how they could make more sales if only the product was changed this way or that. Engineers often hate the idea to changes suggested by salesmen. The finance manager will never like extending of credit terms to customers thus causing displeasure to the sales manger. There is the paramount need, therefore, to see that everybody in the business understands the main objectives of the business and works towards their achievement in active co-operation with others. This is the object of Co-ordination.

Co-ordination is concerned with synchronizing and unifying the actions of group of people. Money and Railey define Co-ordination as "the orderly arrangement of group effort to provide unity of action in pursuit of a common purpose." Instead of regarding it as a separate function of management, it must be considered as the essence of managership.

Principles of Co-ordination : Mary Parker Follet gave the following principles for achieving Co-ordination :

1. Early beginning : Co-ordination must be sought in the early stages of activity. It may often be impossible or at least very difficult if this is attended to after work has proceeded unco-ordinated. Consider, for example, the situation created by the placement of a purchase order for a machine by production manager while the cash budget shows that no funds are available for the purpose.

2. Direct contact : Co-ordination should be attained by direct contact among the parties concerned. This would ensure promptness and avoid red-gypsum.

3. **Reciprocity** : Co-ordination should be regarded as a reciprocal relating to all factors in the situation, viz., production, sales, finances, men and management.

4. **Continuity** : Co-ordination must be maintained as a continuous process.

Techniques of Co-ordination. Louis A. Allen suggests that "a manager, in managing, must co-ordinate the work for which he is accountable by balancing, timing and integrating." This means that balancing, timing and integrating are the basic techniques of Co-ordination.

Balancing means that enough of one thing is provided to support or counterbalance the other.

Timing involves the adjustment of the time schedules of different activities in such a way that they support and reinforce each other.

Integrating implies the unification of the variety of diverse interests for the accomplishment of the organisation objectives.

The following steps and measures have to be adopted in practice to bring about Co-ordination in the working of an organisation :

(i) **Simplified organisation** : In the modern large-scale organisations, there is tendency towards over-specialization. The organisation gets divided into a whole series of units each one of whom concentrates just on its own task. In fact each unit tends to be bureaucratic and its activities become ends in themselves instead of being means to the overall ends of the organisation. This creates problems of Co-ordination. The remedy for this lies in sacrificing some benefits of specialization by placing closely related functions and operations under the charge of an executive who functions as the co-ordinator. Re-arrangement of departments may also be considered to bring about a greater deal of harmony among the various wings of the organisation. The need for clear-cut organisation and procedures can

hardly be over-emphasized. Organisational procedures should cover all activities and each person must be given to understand what he is responsible for and how his work is related to that of other individuals.

(ii) **Harmonized programmes and policies** : Excellent opportunities for co-ordination are provided by the process of planning. The plans prepared by different individuals or divisions should be checked up for consistency. The manager must ensure that all plans add up to a unified programme balance among conflicting plans many be secured by choosing the via media (the middle course) or by evolving a compromise. Co-ordinated activities must not only be consistent with each other, but also performed at the proper time. This is of paramount importance in assembly line production. For instance, the succeeding operations must be timed to follow preceding operations without any waste of time.

(iii) **Well-designed methods of communication** : Good communication is basic to proper Co-ordination. Communication of information is necessary both for making adjustments in plans and for preparing programmes for future. Information needed for another, written reports from departments, oral reports, etc.

(iv) **Voluntary co-operation** : In ideal conditions, co-ordination should take place through voluntary co-operation of the members. This can be secured by instilling dominant objectives among people, developing generally accepted customs and terms, making it easy for people to work with one another, encouraging informal contacts to supplement formal communication, providing liaison man to maintain close contact with various departments, and using committees for informal exchange of ideas and views.

(v) **Co-ordination through supervision** : The supervising executives have an important part to play in co-ordinating the work of their subordinates. Where the workload of an executive is so heavy that he cannot find adequate time for Co-

ordination, staff assistants may be employed. They may recommend to the senior official the action that he may take for ensuring Co-ordination.

12.7 ROLE OF MANAGEMENT FUNCTIONS IN DECISION-MAKING

The applications of management functions are made in decision-making process. The task of management involves making of countless decisions, so much so that some believe that management is decision-making. "Whatever a manager does" writes P.F. Drucker, "he does through making decisions." According to Melvin T. Copeland, "administration essentially is decision-making process and authority is responsible for making decisions and for ascertaining that the decisions made are carried out."

Decision making is as important in planning as in organisation, co-ordination and control, for in each of these functions, the manager has to choose from among a number of alternative courses of action. Chester I. Bernard has distinguished between two classes of acts - those which are the results of deliberation, calculation, thought and those which are unconscious, automatic, responsive. In his view the former are themselves automatic and of which the processes are usually unknown to the actor himself.

The reason why business decisions have to be preceded by systematic deliberation is that there are many alternative courses to most business situations.

A decision may relate to the end or means or both. In some cases an end may be given and the manager is to decide upon the best means of attaining it. In others, the end may have also to be decided through the logical process of reasoning and analysis.

Thus the characteristics of a decision are :

1. It is the end process preceded by deliberation and reasoning ;

2. It is the choice of the best course among alternatives ;
3. It may be negative and may just be a decision not to decide; and
4. It relates the means to an end.

Types of Decisions

According to P.F. Drucker, there are four basic criteria which determine the nature of a decision and the level of authority that should make it. These are : (1) the degree of futurity in it, (2) its impact on the other functions, areas or the business as a whole, (3) the number of qualitative factors that enter into it, and (4) whether it is periodically recurrent or rare, if not unique. If a decision does not commit the company for long or is immediately reversible, it can be taken at a lower level. Similarly, if it affects only one function, it is of the lowest order. The moment, some basic principles of conduct, ethical values, social and political beliefs, etc. have to taken into account, the decision moves into a higher order and requires either determination or review at a higher level.

Likewise, decisions may be broadly classified as major or minor, routine or strategic, policy or operating, depending on the issues involved.

Decisions may also be classified after A. Simon into programmed or unprogrammed on the basis of the procedure adopted.

Steps in Decision making

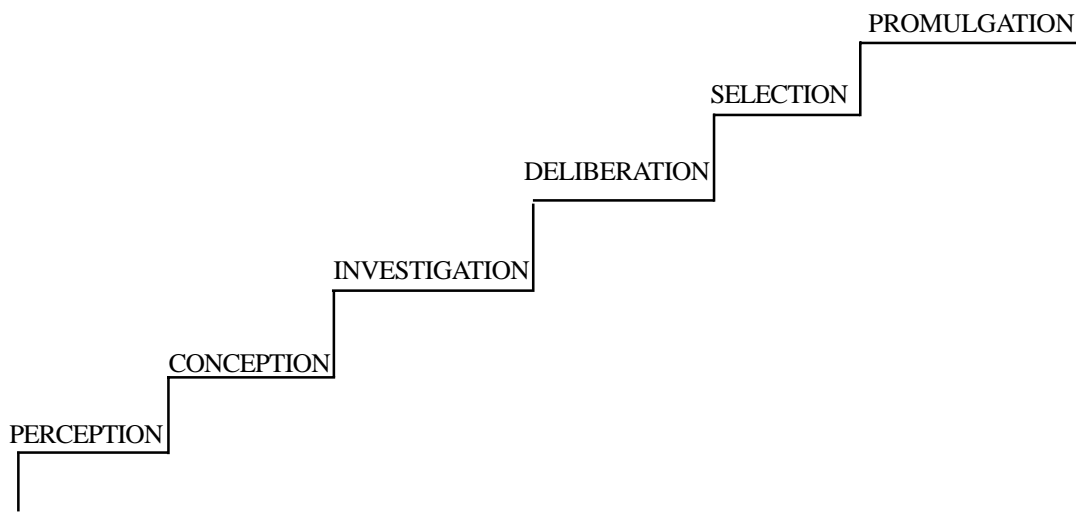
According to Stanley Vance, decision-making consists of the following steps:

1. **Perception** : A state of awareness, out of which a consciousness of being arises.
2. **Conception** : That power of the mind which develops ideas out of perceptions. Concepts might be termed schemes or designs for action.

3. **Investigation** : The search for, and the acquisition of, information pertinent to specific concepts so that the relative advantages and limitations of alternative courses of motion can be compared.

4. **Deliberation** : A mental weighing of relative merits and consequences attached to alternative schemes of selection.

5. **Selection** : A discrimination among the available alternatives so that all persons concerned are adequately notified.



Steps in Decision-Making

.6 **Promulgation** : It is the final step in the process of decision making and here the decision is finally taken by the management.

While the process of thinking involved in any rational analysis generally follows the above pattern, the actual technique of decision-making is much the same as that of planning, of which it is a part. It has the following five phases:

- (1) Defining and analysing the problem.
- (2) Finding relevant fact.
- (3) Developing alternative solutions.
- (4) Selecting the best solution.
- (5) Converting the decision into effective action.

12.8 SUMMARY

Management is the group of activities (functions) which includes drafting plans, preparing policies and arranging men, money, machine and materials required to achieve the objectives. This reveals that management is the activity of man who struggles for better living in the complex and competitive business world. Besides, the management gives satisfaction to and rewards those who are engaged in the operation and ensuring an excellent performance. In other words, management is the process consisting of the functions of planning, organising, staffing, directing and controlling the operations to achieve specified objectives. The real application of different functions of management is made during decision-making. Every manager requires certain decision to make, may it be relating to planning, organising, staffing, directing or co-ordinating. The significance of management functions can not be over emphasised in modern world.

12.9 KEYWORDS

Controlling: It consists of the steps taken to ensure that the performance of the organisation conforms to the plans.

Directing: It is a managerial function which includes three essential components: issuing of orders and instructions; guiding and teaching the sub-ordinates; and supervising the sub-ordinates to insure that their performance conforms to the plans.

Leadership: It is the quality of the behaviour of the individuals whereby they guide people or their activities in organised effort.

Motivation: Creating willingness to work and cooperate for the accomplishment of common objectives among the personnel is motivation.

Organisation: Determining what activities are necessary to any purpose and arranging them in groups which may be assigned to individuals.

Planning: Planning is deciding in advance what is to be done, when to be done, where to be done and how to be done.

12.10 SELF ASSESSMENT QUESTIONS

1. What are the main functions of management? Differentiate between the main functions and the subsidiary functions with illustrations.
2. Management is a continuous operation or process involving the interaction of all functions. Comment.
3. What are the different steps in decision-making ? Discuss and illustrate.

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