BUSINESS ORGANISATION AND MANAGEMENT

Dr. B. R. AMBEDKAR OPEN UNIVERSITY
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PREFACE

Thi book deals with the topics in Business Organisation and Management included in the syllabus for the second year of the B.Com., course offered by the Andhra Pradesh Open University. These topics generally cover the 'Core' area of the subject to be studied in the Second Year of the Three Year Degree course in Commerce (B.Com). The Syllabus for the sake of covenience is divided into Blocks, eachof whichcomprises a numoer of units. Each Block generally covers a specific area of the subject. The units are prepared by specialists in accordance with a format so designed as to enable the sutdent to read and understand them without much difficulty. Each unit begins with a statement of its objectives followed by synopisis and has at its end, questions intended to test the student's comprehension of its subject matter. Technical terms with which the student may not generally be familiar are given at the end of each unit under the head, "Glossary".

Business Organisation and Management has emerged as a very important inter-related discipline. This is mainly due to the importance various countries attach to the process of industrialisation and the steps taken by them in this regard. This subject is essentially concerned with the concpets of industry, business and trade, the process of organising the same, the patterns and forms of organisation, the financial and managerial issues involved, the mangement of business and its environment, the basis and problems of distribution of goods and other allied matters connected with business and trade. An understanding of this subject is as much relevant to the traders, entrepreneurs, managers and practicing businessmen as to the academic community.

The University hopes that this material will help the student to get acquainted with the principal issues in Business Organisation and Management which make for its distinctiveness and significance.

CONTENTS

BUSINESS ORGANISATION AND MANAGEMENT

BLOCK -1

BLOCK-I INTRODUCTION TO BUSINESS

Unit-1 Evolution of Business and Business Concepts
Unit-2 Business Environment and Social Responsibility
Unit-3 Business Promotion

1.2. EVOLUTION OF BUSINESS

1.2.1 Meaning of Business

Business means human activity directed towards the producing and marketing of goods and services. It includes both commerce and indusry. A brief description of the origin and development of commerce and industry will give us a clear picture of the evolution of business. Hence, an attempt is made to explain the development of commerce and industry.

1.2.2 Development of Commerce

Commerce refers to and includes all those activities which are necessary to bring goods and services from where they originate to where they are consumed. It includes trade (i.e, the buying and selling of goods) and the aids to trade (i.e., services such as transport, banking, insurance and warehousing).

Modern commerce is a well-developed system of exchange with well-organised transport, insurance, warehousing and other services which facilitate trades. This system is the outcome of a gradual evolution spread over a long period of human history and in the process, has passes through the following different stages such as the following :

(A) **Household Economy :** This is the first stage of economic development. At this stage, division of labour was unknown except at the family level. Self-sufficiency within the family was the basis of economy and there was no commercial interrelationship between families. While men engaged in jobs like hunting, fishing, making weapons for hunting, etc., women were engaged in fruit-gathering, cultivation of lands, etc., Commerce was unknown at this stage.

(B) **Primitive Barter Economy :** Gradually, the needs of the families increased ; and families started specialising in different occupations and the need for exchange of goods etc., between different families and different places arose. Thus commerce originated. Initially, the barter system was practised. 'Barter' means exchange of goods for goods.

(C) **The Rise of Trade :** In course of time, the needs of the people got multiplied and the need for exchange became all the greater. In the beginning, goods were exchanged at particular fixed places, but gradually, trade appeared on the scene. Home trade began to develop and assume importance and with this, there arose a need for a common medium of exchange. Money appeared as an instrument and medium of exchange. Further, weights and measures also came to be used at this stage.

(D) **Town Economy :** At this stage, trade began to be undertaken for catering to the needs of local markets, which gradually developed into large towns. Further, traders were divided into wholesale and retail merchants. Division of labour became significant and prices for goods began to be fixed regularly and traders started using the credit system.

(E) **International Trade :** At this stage, goods were produced not only for selling in the local markets but also in foreign markets. This expansion of trade was due to the Industrial Revolution which made large scale manufacture of goods possible. Further, middlemen began to operate between the producers and the consumers and also many specialised institutions like commercial banks, insurance companies, transport companies, warehousing companies, etc., began to be set up. These middlemen and specialised institutions played and important role in the development of Trade not only within the country but also with foreign countries.

Check Your Progress - 1

What are the stages in the development of commerce?

1.2.3. Evolution of Industry

The evolution of industry also has passed through a number of stages such as the following :

(A) **Handicraft system** : Under this system, the artisans living in villages produced the requirements of local people. They worked on the basis of yearly payment received from the farmers in exchange of goods supplied or services rendered throughout the year. Thus in India, even today we find Carpenters and Blacksmiths rendering services to the farmers throughout the year and receiving generally in the harvest season a fixed payment for them in kind.

The special features of this system were as follws :

the production process was simple;
the use of machinery was minimal;
the capital required was not considerable; and
most of the work was done by hand.

(B) **Guilds** : The second stage in the evolution of industry was the development of guilds. In this phase, the artisans of different crafts working in a local area or place formed associations (which were called 'Craft Guilds') in order to protect and develop their business interest and also to maintain high standards of production Generally a seperate guild was formed for each craft. These guilds after functioning successfully for a long period of time, declined in importance and finally withered away. Some important reasons for their decline and disappearance were:

the rigid outlook of member-craftsmen ;
restrictions on fresh entrants to the craft; and the
emergence of new towns without guild authority

(C) **Domestic System** : In this system, the merchants began to enter into contracts with artisans and workers for regular supply of goods. With the demand for their products increasing the artisans found it difficult to provide for the regular supply of the needed raw materials. Hence, at this stage, the merchants took the responsibility of supplying raw materials required by the artisans and also of marketing the finished products of artisans. The merchant in this way, became the entrepreneur and middleman between the producer and consumer.

In the 17th Century, here were improvements in the techniques of manufacrure and in the 18th Century, a few inventions were made. These developments resulted in the use of machines and tools by the workers. But the machines and tools were beyond the means of workers. This led to the setting up of machines by merchants in their own buildings who hired the workers for manufacturing the goods under their supervision. This kind of domestic manufacture became the forerunner of the modern factory system and gave rise to capitalism and the emergence of the entrepreneurship.

The consequences of this change were that :

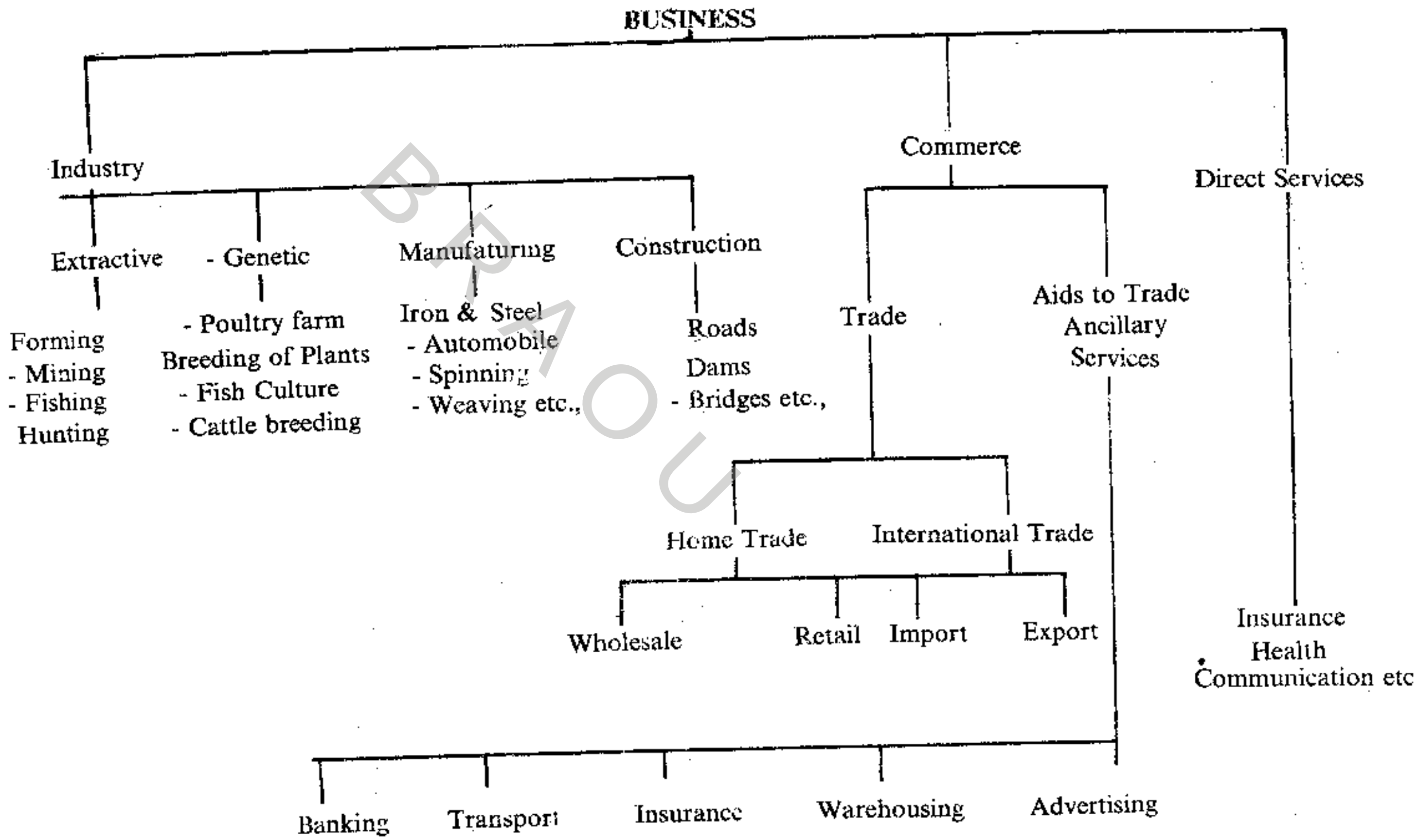
the artisans lost their independence ; and that
they became hired workers.

(D) **Factory System** : The Industial Revolution which started in England in the second half of the 18th Century soon spread to other countries. The old industrial order with small manufacturers employing a small number of workers and using limited capital disappeared giving place to a new one based on large scale production. Domestic production was replaced by the factory system. The workers worked in large factories located mostly in cities. These factories produced goods in large quantities meant for meeting the needs of consumers not only within the country but also in foreign countries.

To manufacture goods in large quantities, the old machines were replaced by new machines which were complicated and driven by power. Large scale production increased the need for large investment of capital. This resulted in the Capital becoming a dominating factor of production and the ownership of the industrial uint passing into the hands of the supplier of capital. This new system came to be known as the 'factory system'. It is the latest system in the development of industry.

Chart : 1

Concepts of business



1.3 BUSINESS CONCEPTS

There are various concepts concerning business which are discussed here under :

1.3.1 Business

'Business' refers to all human activities which are concerned with the production or purchase of goods and services with the intention of selling them at a profit. It includes economic activities such as manufacturing, trading, transportation, insurance, warehousing, banking and finance. The important characteristics of business are :

(A) **Sale or transfer for value :** Busuness involves the slae or transfer of goods and services for value. The Production or purchase of goods and services for personal consumption does not come under business whereas the production or purchase of goods and services with the object of exchanging them for value comes under business. Thus, a weaver weaving a cloth for his own use is not engaged in business, but if he weaves it for sale, it becomes business.

(B) **Dealing in goods and Services :** Business consists of transactions relating to goods and services. The term 'goods' includes both consumer goods like wheat, rice, oil, cloth, etc., and producer goods like tools and machinery. The term, 'Services' refers to such things as banking, insurance and transportation of goods and passengers.

(C) **Recurrence of dealings :** In business, there is recurrence of purchase and sale. If a person sells his personal scooter and earns a profit, his act is not one of business. But if he regularly purchasesand sells scooters, then such an act is considered business.

(D) **Profit Motive :** The primary motive behind business is to earn profit. It is concerned with the production and purchase of goods and services with a view to selling them at a profit.

(E) **Risk :** Profit from business depends on many factors like demand, price level, competition, etc., on which businessmen may not have control. Hence, business involves an element of risk.

(F) **Components of business :** Business includes industry, trade and commerce. While industry is concerned with the production of goods and materials, trade and commerce are concerned with their distribution.

1.3.2 Industry

The term, 'Industry', refers to the process of extraction and production of goods whether for final consumption or for use in further production.

Types of industry : The following are the different types of industry :

A) Extractive industries
B) Genetic industries
C) Manufacturing industries
D) Construction industries

A) Extractive Industries : These industries are concerned with the discovery and utilisation of natural resources like minerals, animals and plants and trees. Some examples of extractive Industries are farming, mining, hunting and fishing.

B) Genetic Industries : These industries include breeding of plants, poultry farms, fish culture and cattle breeding farms.

(C) Manufacturing industries : These industries are engaged in the conversion and transformation of raw materials and partly finished materials into finished products. Some examples of manufacturing industries are iron and steel industries, sugar industry and cotton textile industry.

(D) Construction industries : These industries are engaged in constructional activities like the construction of buildings, bridges, dams, etc.

1.3.3. Trade

Trade is a branch of Commerce and it is concerned with the exchange of commodities. It means the buying and selling of goods. It does not include aids to trade like banking, insurance, transportation, wareshousing, etc. Trade can be classified into wholesale trade and retail trade. Trade is also Classified as local trade, regional trade, internatinal trade or foreign trade.

1.3.4 Commerce

The term, 'commerce', refers to trade and all activities which facilitate trade such as transporting, insuring, storing, financing, grading and packing. Thus commerce includes trade as well as aids to trade.

There is a need to remove hindrances for conducting the trade. The hindrances include those stemming from person, place, time, finance and knowledge. One person may produce some goods and another person may need them for consumption. This hindrance of person is removed by traders who serve as a link between the producers and the consumers. Hindrance of place occurs when goods are produced at one place and consumed at another place. This hindrance is removed with aids like packing, transportation, and insurance.

Hindrance of time arises out of the time gap between the time of production and time of consumption. It is removed by warehousing.

The hindrance of finance is removed by banking and the hindrance of knowledge is removed by advertising and publicity.

Check your progress-2

What do you know about extractive Industries?

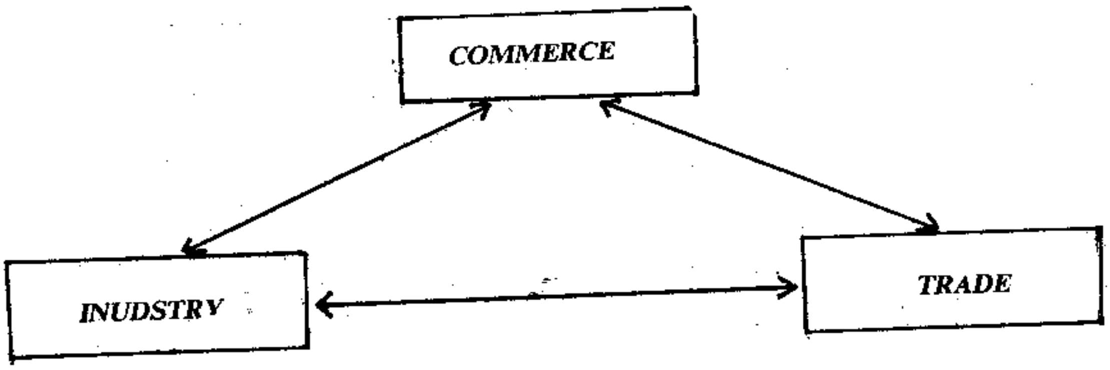
1.3.5 Service enterprise

These refer to the enterprises which are engaged in providing services. Some examples of service enterprise are Cinema houses, transport companies and insurance companies.

1.3.6 Inter-relationship between business activities

Industry, commerce and trade are closely related to one another, and as such they affect and are in turn affected by one another. Each has to depend on the other for realising its objectivities. For example, industry which is concerned with production depends upon commerce for the distribution of its products and similarly commerce has to depend upon industry for the supply of products. Commerce helps industry both before and after production through the buying of raw materials, the selling of finished products and the conducting of many other operations.

Trade which is concerned with the process of buying and selling goods provides support to industry and ensures the smooth flow of commerce. Thus industry, commerce and trade are closely related to one another and are inter-dependent as shown in the figure below.



1.3.7 Objectives of Business

Though it is generally believed that the aim of business is to earn profits, a business unit cannot afford to have profit alone as its sole objective. Henry Ford stated that business is not mere money chasing but that it also should aim at serving the community.

Business should have an objective of earning a reasonable profit through customer satisfaction. According to Prof. Urwick, 'Profit can no more be the objective of a business than eating is the objective of living'. Humanbeings do not live with the sole objective of eating and similarly business cannot exist with the sole object of earning profit. However, profit plays an important role as criterion for success. It is the measuring rod of business performance. Moreover, a firm has to avoid losses if it wants to survive for long. If the firm is rendering some useful service, it is necessary that it should continue to function, since its closure may affect the producers, workers, and consumers. Hence, business has to earn at least the profit that is required to enable it to stay in business.

According to Peter Drucker, the customer is the foundation of a business and keeps it in existence. Hence, the purpose of business is to cater to the needs of customers.

A business concern also has human objectives. It must fulfil its responsibility towards its employees by providing good working conditions and reasonable wages.

In addition, it has to safeguard the interests of suppliers, financiers, etc., with whom it has business dealngs.

A detailed study of this aspect is made in unit No.2, viz. BUSINESS ENVIRONMENT AND SOCIAL RESPONSIBILITIES. Here it should be noted that business has the following economic and social objectives.

Economic objectives

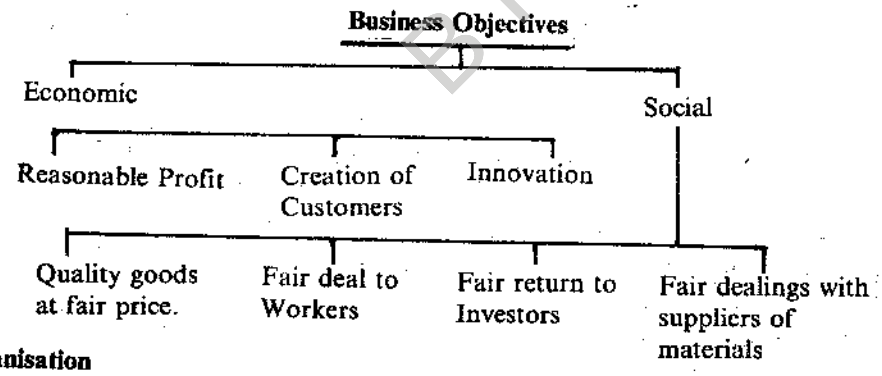
a. Earning of satisfactory profit.
b. Creation of customers.
c. Making innovations which help the customers in getting better and more economic goods and services.

Social Objectives

a. Supply of quality goods to the community.
b. Fair deal to workers.
c. Fair return to investors
d. Fair dealings with suppliers.

The Chart given below Summarises the objectives of business :

Chart II



1.3.8 Organisation

Business is an economic enterprise involving a combination of economic factors, namely capital, labour, patronage and organisation. Organisation brings other factors into a harmonious productive whole in order to achieve the objective of the enterprise. In this context, the term 'Organisation', refers to the external form or framework of the organisation. It covers the following aspects :

a) Ownership;
b) Risk Bearing;
c) Control; and
d) Distribution of profit.

Depending on the nature of these aspects, 'organisation' takes different forms such as sole proprietorship, partnership, joint stock company, co-operative society and public corporation. These external forms of organisation are different from the internal organisational structure of an undertaking which provides a framework for enabling a group of persons to work together.

The external forms of organisation will be discussed in detail in Units-2,3,4 and 5 and the internal organisation in Unit-9.

1.4 SUMMING UP

The development of Commerce and Industry would lead to the evolution of business. Business means production and marketing of goods and services. The development of commerce is vitally connected with all the activities that are inter-related to bring the goods from the place of origin to the place of consumption. The development of industry shaped into different systems like 1. Handicrafts system; 2. Guilds system; 3. Domestic system and 4. Factory system. The operation of the whole industry in the above systems yields good results thereby serving the public and has come to stay with democratised principles of the society.

This unit explained the concepts of the business. First the concept of business and its characteristics were explained and there by industry, trade and commerce were also analysed. The relationships between industry, Trade and Commerce were analysed in detail and finally business activities are explained. This unit gives conceptual clarity of the different business terms looks ahead for the business environment and social responsibility.

1.5 CHECK YOUR PROGESSS : MODEL ANSWERS

1. 1. Household economy.
   2. Primitive Barter Economy.
   3. Town economy
   4. Internatonal Trade.
2. These industries are concerned with the discovery and utilisation of natural resources like minerals, animals, plants and trees.

1.6 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. Examine the inter-relationships of industry, commerce and trade.
2. Explain the various stages in the evolution of industry.
3. Discuss the characteristics and objectives of business.

B. SHORT QUESTIONS

4. What is house economy ?
5. Mention the stages in the evolution of commerce
6. What are 'Guilds'?
7. Mention the stages in the evolution of industry.
8. What do you mean by commerce?

1.7. RECOMMENDED BOOKS

Bhushan Y.K. : 'Fundamentals of Business Organisation and Management' Sultan Chand, New Delhi.

		and Sons, 1978.
Krishnaswami OR	:	'Essentials of Commerce' Eagle Press Publication Division, Madras, 1978.
Reddy P.N. and Gulshan	:	'Principles of Business Organisation and Management' S. Chand & Co., Ltd., New Delhi, 1981.

1.8. GLOSSARY

Business	:	Refers to all human activities which are connected with the production or purchase of goods and serve with the intention of selling them at a profit.
Commerce	:	Refers to and includes all those activities which are necessary to bring goods and services from the place of their origin to the places of their consumption. It includes trade and aids to trade.
Trade	:	Trade is a branch of commerce and it is concerned with the exchange of commodities. It means the buying and selling of goods.

UNIT-2 : BUSINESS ENVIRONMENT AND SOCIAL RESPONSIBILITY

Contents

2.0 AIMS AND OBJECTIVES

This Unit introduces the meaning of Business environmet and the social obligation of business firm towards various sections of people.

At the end of this unit you will be able to :

- know the business environment
- describe objectives of the business enterprises
- explain the social responsibilities of business towards owners, consumers, workers, society and Government.

2.1 INTRODUCTION

The environment under which the activity is operated is more important for the business. This would give a support to the business. The business environment conssits of social, economical, political and technological factors. The business should have specific objectives to be achieved in the course of its activity. One of the major objectives of business is the social responsibility of business.

Government have became more democratic and Government institutions are coming forward to start different business activites. realising the need for social responsibility of business, the government now tell the people that business is not for profit alone, but for something else. Business has a reponsibility towards owners, customers, workers, society and finally the Government.

2.2 BUSINESS ENVIRONMENT

2.2.1 Meaning

A business does not operate in a vacum; but in a complex set-up. The set up in which a business operates is known is business environment. it is the sum of physical and other factors which influence and is influenced by it. Management in order to exist and grow must know the overall environment within which the business operates. Further, even the objectives of the business must be formulated by the Management only after taking into account the business environment.

The environment of a business firm comprises several segments which may be classified as follows:

1. **Social :** This segment consists of consumers, employees and social institutions which get benefit from the business or bring benefit to it.
2. **Economic :** This includes the whole economy, the various economic institutions as well as other organisations with which a business firm has to deal.
3. **Political :** This comprises the political institutions of the country including the Government and Legislature which assume the responsibility for regulating the activities of business and receive funds from business firms by way of taxes, cess, fees, etc.
4. **Technological :** This segment consists of technical know-how and production and management technology available to business organisations at any point of time or over a period of time.

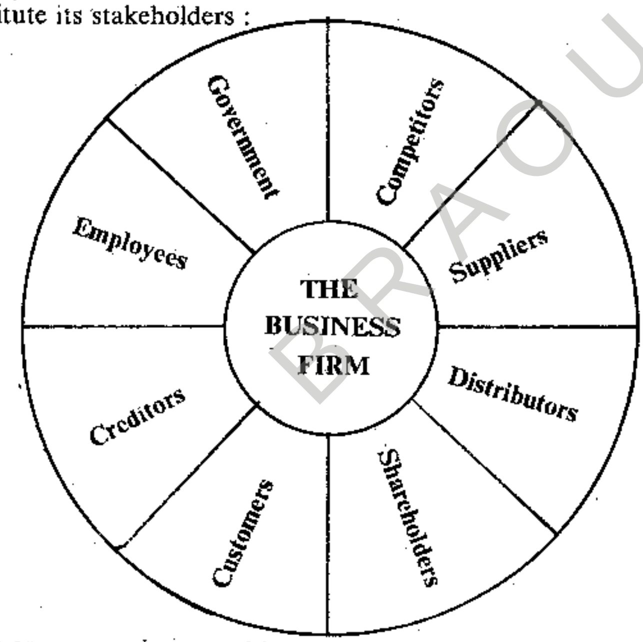
2.3 OBJECTIVES OF BUSINESS

In this section,it may be pointed out that business is not meant just for earning profits for its owners, because it has to cater to the interests of various groups who have a stake in the business.

2.3.1. Interest groups

Various interest groups which have a stake in the business help and contribute to the firm's continuity and prosperity and in turn claim a return in different forms from the firm. These stakeholders consists of consumers, employees, stock holders, creditors, suppliers, distributors and the Government. A business firm's continuity and prosperity depend upon its relations with all these interest groups.

The following diagram indicates the relations of the business firm with different interest groups which constitute its stakeholders :



As all the interest groups are interested in the working of a business enterprise, it needs to have a multiplicity of objectives in order to reconcile the conflicting interests of the stakeholders and to ensure harmony in its dealings with them. According to Peter F. Drucker, a business firm should have the following objectives :

1. **Creation of profitable market (Market Standing) :** Every business should have the objectives of creating a profitable market. This can be acieved by attracting customers. According to Roger Falk, 'Customer is the foundation of all business and business is for the most part the creation of customers'. As the fate of business depends on the customers, the businessman should establish his standing in the market by constantly searching for customers who have the desire and capacity to pay for his products.
2. **Innovation :** Another objective of business is innovation. Innovation involes the discovering of ways and means for improving the product or service. This helps the enterprise in

Check your progress-2

What is social responsibility?

2.5 SUMMING UP

Business environment is an important one where the whole business cycle operates. It comprises of social, economic, political and technological factors. Before starting any business, the proposed objectives should be visualised. The prupose of the business is not just to earn profit but to serve the different groups that are connected with these business activities. The interest groups in the business are customers, shareholders, employees, distributors, creditors, suppliers, competitors and finally the Govt. The business, apart from serving the interest groups, should have some objectives like maintaining productivity, creation of market providing financial resources for the business.

The business, in the modern times has different perspectives of having a social responsibility towards its business. Social responsibility is nothing but promoting the welfare of the society as a whole along with its own interest.

The need for social responsibility is an important issue to be considered for the purpose of social developement. In the olden days,business was only for the profit. In the present days, there are many democratic governments and the people's representatives are elected to form the government which will serve the needs of the public and protect the interests of the society.

CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Owners of the enterprise ii) consumers
   iii) Workers; iv) Soceity v) Government
   vi) Economic policy.
2. It is concerned with the welfare of the society and social values as a whole along with its own interests.

2.7 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. Briefly explain the economic and social objectives of business
2. Explain in detail the social responsibilities of business towards its employees, customers and the community at large?
3. 'The duty of business in a democracy is to follow the social obligations which are defined by the Whole community'. Discuss.

B. SHORT QUESTIONS

4. What is business environment?
5. State the objectives of Business?
6. What do you mean by 'Social Responsibility of business'?

2.8 RECOMMENDED BOOKS

Bhushan Y.K. : 'Fundamentals of Business Organisation and Management', Sultan Chand and Sons. New Delhi, 1978.

Krishnaswami OR : 'Essentials of Commerce' Eagle Press Publication Division, Madras, 1978.

Reddy P.N. and Gulshan : 'Principles of Business Organisation and Management' S. Chand and Co., Ltd., New Delhi, 1981.

2.9. GLOSSARY

Business Environment : The set-up in which a business operates, i.e., the sum total of physical and other factors which influence a business and is influenced by it.

Social Responsibilities of Business : Refers to such decisions of a business concern which promote the welfare of the society as a whole along with its own interests, i.e., the business concern acts in a manner that will accomplish social gains along with the traditional economic gains which the business concern seeks.

UNIT-3 : BUSINESS PROMOTION

Contents

AIMS AND OBJECTIVES

This unit covers meaning of Business promotion, characteristics, and steps in promotion. At the end of this unit,you will be able to know:

- Meaning of promotion and promoter
- the characteristics of promotion
- the steps in promotion

3.1 INTRODUCTION

In the earlier units,Business concepts and the business environment were studied. In this unit, you will learn the meaning of promotion and promoter. Next, the characteristics of the business promotion are studied. Afterwards, the study of the different steps involved in business promotion and finally the different factors affecting the choice of organisation are also studied.

3.2 BUSINESS PROMOTION AND PROMOTER

3.2.1 Meaning of Promotion

A business enterprise does not come into existence of its own. It comes into existence as a result of the efforts of an individual or a group of people or an institution. That is, it has to be promoted by some person or persons.

The process of business promotion begins with the conceiving of an idea and ends when that idea is translated into action i.e., the establishment of the business enterprise and commencement of its business.

In order to have a clear idea of the meaning of the term 'Promotion', let us consider the definition given by some well known authors.

According to Harry G. Guthmann and Herbert E. Dougall, 'Promotion starts with the conception of the idea from which the business is to be evolved and continues down to the point at which the business is fully ready to begin operations as a going concern'.

Henry E. Hoaghland defines promotion as 'the process of creating a specific business enterprise'. Its scope, according to him, is very broad and numerous individuals are frequently asked to make their contribution to the programme. In any specific case, promotion begins when some one gives serious consideration to the formulation of the ideas upon which the business in question is to be based. From this time, until a corporation is organised and plans are completed to exploit the idea, the aggregate of activities contributed by all those participating in the building of the enterprise constitute promotion'.

Another writer Mr. C.W. Gerstenberg, defines promotion as 'the discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profits therefrom'

Check your progress-1

Define Promotion?

3.3 CHARACTERISTICS OF PROMOTION

3.3.1 Characteristics

From the definitions given above, we can identify the chief characteristics of promotion. They are as follows:

1. Promotion of a business enterprise is a process consisting of the following steps:
   a) discovery of a business idea;
   b) investigation of the business ideas;
   c) assembling of the inputs like capital, land, labour etc.; and
   d) formation of the appropriate business organisation such as sole proprietorship or a partnership or company by complying with all the required legal formalities.
2. Promotion refers to the starting of a new business. New business means not only the discovery of new ideas and the establishing of a new business but also the exploitation of an already existing idea and the finding of a new business.
3. Promotion refers not only to the establishment of the company form of organisation but also to other forms of organisation such as sole proprietorship, Joint Hindu family firm, partnership and co-operative organisation. Whatever be the form, the broad steps involved in them are the same for all, but the nature and complexity of work to be done may vary according to the form. For example, the process of formation of the company form of organisation is more complex than that of other forms like sole proprietorship and partnership. In the sole trading concern, there is no problem of registration, whereas in the case of a company, registration is compulsory which involves a cumbersome and lengthy procedure.

3.3.2 Promoter

The person who is concerned with the promotion of a business enterprise is known as the 'Promoter'. The promoter is a person who conceives the idea of starting a business and takes all the measures required for bringing the enterprise into existence.

Promoters are of different types such as professional promoters, occassional promoters, promoter companies, financial promoters, entrepreneurs, lawyers and engineers. A more detailed discussion of 'promoter' is made in unit No 7

3.4 STEPS IN PROMOTION

The promotion of a new enterprise is beset with a number of problems. The entrepreneur or promoter has to invest huge amounts and naturally, he expects a good return on his investment. To arrive at a decision to promote an enterprise, he has to consider carefully many factors; otherwise, he may have to face problems at a later stage. Further, the promoter has to make a large numner of decisions in connection with the promotion of an enterprise.

The various steps in the promotion of a business enterprises are:

3.4.1. Development of idea;
3.4.2. Determination of objectives and broad policies;
3.4.3. Product analysis and market survey;
3.4.4. Selection of the form of organisation;
3.4.5. Determination of the size and location
3.4.6.Physical facilities;
3.4.7. Financial planning;
3.4.8. Recruitment of labour force;
3.4.9. Designing the industrial organisationas structure.

3.4.1. Development of Idea

The first problem of an entrepreneur is to conceive the idea of a specific business opportunity. This idea may strike him on account of his awareness of unexplioted natural resources or unused supply of raw materials or potential demand for a certain product or profitability of certain lines of business or government's and encouragement for certain lines of business.

3.4.2. Determination of objectives

After arriving at a decision to establish a business in a particular line, the entrepreneur has to determine the objectives of the enterprise. The decision relating to the objective is very important because the future of the concern and its working are determined by its objectives. Further, the objectives of the enterprise must be such that it should be possible for the concern to achieve them.

3.4.3. Product analysis and market survey

It is also necessary for an entrepreneur to conduct an analysis of the product and its market from the point of view of the customer. For this, he has to collect data on consumer preferences and needs through market research techniques and to find out the saleability of the proposed product within a given price range. Further, the market research also should cover consumer preferences in respect of design, colour, size and shape. In addition, the entrepreneur should try to find out the total demand, trends in demand, potential demand and the degree of competition for the proposed product.

3.4.4. Selection of form of organisation

Another important decision to be taken by entrepreneur relates to the selection of form of business ownership, i.e., whether it should be sole proprietorship, partnership, Joint Hindu family firm, Company or a co-operative form of organisation. Each form of organisation has its own merits and demerits. The promoter has to slect the form of organisation by considering a large number of factors such as nature of business activity, availability of capital, demand conditons for the product of the proposed enterprise, marketing facilities, available infrastructure, incentives from government, tax advantages and the degree of risk involved. It may be noted here that in the case of some business like banking and insurance, the form has to be that of an incorporated company and hence, the promoter has no choice in that regard. Again, if the enterprise to be started is of a very large size, 'comapny' is the only feasible form of organisation. Since the decision regarding the choice of the form of organisation is important. It will be discussed later.

3.4.5. Determination of size and location

Size of the firm : The next problem relates to the size of the enterprise. The decision regarding the size of the enterprise is influenced by the nature of the enterprise proposed and the form of organisation. In fact, the size of the unit and the form of organisation are inter-dependent. The other factors which entrepreneur has to consider on deciding the size of the proposed enterprise are the technical, managerial marketing and financial aspects. By considering all the factors, the entrepreneur tries to arrive at the most economical and efficient size.

Location : The decision relating to location is to be taken only by taking into account a lage number of factors. The factors to be considered are :

i. Nearness to the market to be served;
ii. Transportation facilites;
iii. Nearness to and availability of adequate supply of water, power and fuel;
iv. Regional tax situation;
v. Nearness to the source of raw materials;
vi. Availability of labour;
vii. Regulations imposed by the Government; and
viii. Climatic conditions.

Thus the factors to be considered are many. But no single place may fullfil all these considerations. Hence the promoter has to weigh the relative advantages of alternative places in relation to the above mentioned factors and select that place which provides the greatest measure of net advantage.

Selection of site: After deciding the area for locating the business, the promoter has to select the exact site. For this purpose, he has to consider the following factors:

1. Availability of adequate land area and its development cost;
2. Availability of water, power etc;
3. Drainage and soil conditons;
4. Nearness to other plants or institutions which the new enterprise may serve or from which it may get materials or services;
5. Facilities for railway sidings for receiving raw materials and the transporting of finished goods;
6. Government regulations and restrictions;
7. Proximity to the main road; and
8. In the case of a small enterprise, nearness to local market.

3.4.6. Physical facilities :

Promotion also involves consideration of such problems such as provision for plant, building, equipment and proper layout.

The provision of physical facilities involves decisions regarding the character of the building, yard space, general layout of the establishment and the proper installation of equipment and machinery. Decisions relating to equipment and machinery and their layout and type of building depend on the nature of process, sequence of manufacturing operations, volume of production and cost and efficiency of various types of machinery and equipment. The promoter has to take correct decisions relating to physical facilities because the efficient functioning of the enterprise depends upon them.

3.4.7. Financial Planning :

Capital is one of the essential requirements for starting a new enterprise. The promoter has to arrange capital for fixed investments like land, building, machinery and for working capital to finance labour, materials, supplier and other currnet costs. In the case of a small concern, the entrepreneur himself arranges it from his own resources, but in the case of a Joint stock company, finances have to be secured from an outside source by issuing shares.

The enterpreneur has to do financial planning which involves the follwoing :

a) determination of the total amount of capital required for the proposed enterprise;
b) determination of the capital structure (ie., the sources of capital and their relative proportions);
c) estimation of the returns on the investment;
d) gestation period of the proposed concern; and
e) determination of the time appropriate for financing the enterprise.

3.4.8 Recruitment of labour force

Yet another problem of promotion is to secure adequate and desired labour force, both skilled and unskilled. He has to make an estimate of the number of workers of different categories required for various Departments and Sections and arrange for their recruitment. There are different sources of labour from which requirements may be made. Sometimes labour may be drawn from other concerns which are in existence. In such cases, the entrepreneur has to see that such labourers are not those rejected by the original concern because of their inefficient performance.

3.4.9: Designing the internal organisation structure

The next problem of entrepreneur is todesignthe internal organisation structure for his proposed concern. This involves breaking up of the total work of the enterprise into major functions like production, marketing, finance, personnel, purchase, engineering etc. and the dividing of each of them into sections. While the major functions are under the control of Departmental Heads like Production Manager, Marketing Manager, Fiancial Manager/Controller, etc., the Sections are supervised by the Section Officers or Heads. Further, the entrepreneur has to stipulate the functions of different Departments and their inter-relationships. The efficient functioning of the concern depends to a large extent on the nature of the structure and hence, the entrepreneur has to carefully plan the organisation structure of his enterprise.

Check your progress-2

What are the main steps in promotion?

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3.5 SUMMING UP

Business promotion is an important issue in the development of business, without this, business promotion can not organise the business on profitable lines. Here the business promoter plays a crucial role in the promotion of the business. This unit dealt with the different features of business promotion. After this,the different steps that are involved in the process of business promotion. are given in detail. Special care was taken to analyse the merits and demerits, of each step in the promotion of business. Among all the steps in business promotion, the location of business, physical facilities, financial planning and finally the recruitment of labour force were given top priority.

3.6 CHECK YOUR PROGRESS : MODEL ANSWERS

1. **Mr. C.W. Gerstenberg,** defines 'promotion as the discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making our profits therefrom'.
2. i) Discovery of a business idea
   ii) Investigation of business ideas
   iii) Assembling of the inputs like land, labour and capital; and
   iv) Formation of appropriate form of organisation.

MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. Explain the various problems relating to the establishment of a new entreprise.
2. Explain the various decisions to be made by the promoter in connection with the establishment of a new enterprise?

B. SHORT QUESTIONS

3. Define 'Promotion'?
4. Who is called a promoter?
5. List the factors to be considered for slecting the form of organisation.
6. What is 'Market Survey'?

3.8 RECOMMENDED BOOKS

Bhushan Y.K.	:	'Fundamentals of Business Organisation and Management' New Sultan Chand and Sons, Delhi, 1978.
Krishnaswamy OR	:	'Essentials of Commerce' Eagle Press Publication Devision, Madras, 1978.
Reddy P.N. and Gulshan	:	'Principles of Business Organisation and Management' S. Chand and Co., Ltd., New Delhi. 1981.

3.9 GLOSSARY

FINANCIAL PLANNING	:	The process of estimating the amount of capital to be raised, determining the form and proportionate amount of securities to be issued and laying down the policies conernmg the implementation of the plan.
MINIMUM SUBSCRIPTION	:	It is the minimum amount which in the opinion of the Directors is necessary to provide for preliminary expenses, underwriting commission, working capital, etc.
PROMOTER	:	The person or persons who undertake the responsibility of bringing the company into existence.
PROMOTION	:	The process of discovering a business proposition and taking all the required steps to implement it.
SERVICE ENTERPRISE	:	Refers to the enterprises which are engaged in providing services, e.g., Cinema houses and transport companies.

BLOCK-II : FORMS OF BUSINESS ORGANISATION

UNIT-4 : TRADITIONAL FORMS OF ORGANISATION

Contents

4.0 AIMS AND OBJECTIVES

This unit introduces the forms of business organisation and with special reference to traditional forms of organisation.

The student will come to know/
- the various forms of business organisation
- the characteristics of an ideal form of organisation
- the features, advantages and disadvantages of sole proprietorship and Joint Hindu family form of organisation.

4.1 INTRODUCTION

In the previous units, the business concepts, environment and the business promotion were studied and this unit gives a detailed note on different forms of organisations and the characteristics of an ideal form of organisation. This would also give detailed discussions on the sole proprietorship and Joint Hindu Family Form of Organisations.

4.2 1. FORMS OF BUSINESS ORGANISATION

Business concerns are established with the objective of making profits. They are engaged in one or more lines of business such as manufacturing and marketing or trading, or aids to trading such as banking, insurance and transportation. They can be established either by one person or by a group of persons in the private sector or by the Government of other public bodies in the public sector. A business started by only one person is called 'sole proprietorship', the business started by a group of persons can be either Joint Hindu Family or partnership or joint stock company or a co-operative form of organisation.

Thus there are various forms of business organisation, viz.,

a) Sole Proprietorship

b) Joint Hindu Family firm
c) Partnership
d) Joint Stock Company
e) Co-operative Society

These forms of organsation refer to such aspects as ownership, risk bearing, control and distribution of profit. Any one of the above mentioned forms may be adopted for establishing a business, but usually one form is more suitable than the other for a particular enterprise. The choice will depend upon variours factors like the nature of business, the objective, capital required, scale of operation, state control, legal requirements and so on.

Check Your progress-1

List the various forms of business organisation.

4.3 CHARACTERISTICS OF AN IDEAL FORM OF ORGANISATION

Before we discuss the features, merits and demerits of different forms of organisation, let us find out the characteristics of an ideal form of organisation. The characteristics of an ideal forms of organisation are found in varying degrees in different forms of organisation. The enterpreneur, while selecting a form of organisation for his business, should consider the following factors :

4.3.1. Simplicity

It should be easy to form the organisation. The formation process should not involve many legal formalities and it should not be time consuming.

4.3.2. Mobilisation of Capital

The form of organisation should facilitate the raising of the required amount of capital at a ressonable cost. If the entreprise requires a large amount of capital, the preconditions necessary for attractive capital from the public are a) safety of investment, b) a fair return on investment, and c) transferability of the holding.

4.3.3 Limit to Liability

A business enterprise may be organised on the basis of either limited or unlimited liability. From the point of view of risk, limited liability is preferable. It means that the liability of the owner as regards the debts of the business is limited only to the amount of capital agreed to be contributed by him. Unlimited liability means that even the owners' personal assets will be liable to be attached for the payment of the business debts

4.3.4 Direct relationship between ownership, control and management

The responsibility for management or control of management must be in the hands of the owners of the firm. If the owners have no control on the management, the firm may not be managed efficiently.

4.3.5. Continuity or stability

Stability is essential for any business concern. Uninterrupted existence enables the entrepreneur to formulate long-term plans for the development of the business concern.

4.3.6 Flexibility of operation

Another ideal of a good form of organisation is flexibility of operation. Changes may take place either in market conditions or the State's policy towards industry or in the conditions of supply of various factors of production. The nature of organisation should be such as to be able to adjust itself to the changes without much difficulty.

4.3.7 Lighter tax liability

All forms of organisation are subject to levy of taxes by the State. But some forms are liable to pay taxes at higher rates while some other may be liable to pay tax at lower rates. Hence, other things being equal, the ideal form of organisation is one which is subject to taxation at a low rate.

4.4 SOLE PROPRIETORSHIP

4.4.1 Meaning

A sole proprietorship or one man's business is a form of business organisation owned and managed by a single person.He is entitled to receive all the profits and bears all risks of ownership.

4.4.2 Features

The importnat features of Sole Proprietorship are :

1. The business is owned by only one person
2. The business is controlled by a single individual
3. The risk is born by a single person
4. The liability of the owner of the businss is unlimited. It means that his personal assets are liable to be attached for the payment of the liabilities of his business.
5. The business firm has no seperate legal entity apart from that of the sole proprietor, and so the business lacks perpetuity.
6. To set up sole proprietorship, no legal formalities are necessary, but there may be legal restrictions on the setting up of particular types of business. For example, an individual cannot start a bank or an insurance company If any one wants to start a cycle shop or a book shop, he may do so without any legal formalities. But in some cases, a licence may be necessary ; for example, if one wants to start a restaurant, he will have to obtain licence from the Municipal Corporation.
7. As the individual bears the entire risk of his business, he derives the total benefit and need not share it with any one.
8. The proprietor has complete freedom of action and he himself takes decisions relating to his firm.
9. The proprietor may take the help of the members of his family in running the business.

4.4.3 Advantages

The advantages of the sole proprietorship form of organisation are as follows :

1. **Ease of formation :** It is easy to start a sole proprietorship as no legal formalities are required to be observed. Further, no complicated procedure is involved in starting this form of organisation. Even a person with limited means can start a business of his own.
2. **Incentive :** As all the profits of the business belong to one person, the owner has the incentive to take a personal interest in his business and manage it effectively and efficiently.
3. **Freedom of action :** The proprietor himself takes the decisions relating to his business and there is none to interfere with his authority. This type of freedom of action promotes initiative and self-reliance.
4. **Quick decision :** There is no need for the proprietor to consult any other person relating his business matters and so is in a position to take quick decisions.
5. **Flexibility :** Because of the quick decisions that can be taken by the proprietor, he can adopt himself to the changing situation with comparative ease. Further, flexibility is facilitated by the small investment, which can be very easily adopted to the changing situation.
6. **Personal touch :** As the proprietor himself manages the business, he is able to come into close contact with the customers of his business and also attend to their needs promptly. This helps him to earn goodwill for his business.
7. **Business secrecy :** As only one man is concerned with the business decisions, methods and policies, it is easy to maintain business secrecy. Maintaining business secrecy is very important in competitive business.
8. **Social desirability :** Sole proprietorship ensures that too much wealth does not concentrate in a few hands, as the business is a small one. This is desirable from the social point of view.

4.4.4 Disadavantages

Some of the disavantages of the Sole Proprietorship are :

1. **Limited resources :** As only one person contributes to the capital of the business, the capital is limited to his capacity. Because of limited resources, the expansion of business cannot easily take place.
2. **Limited managerial ability :** The managerial abilities are also limited. Because of this, it may not be possible for one person to own and manage a large business.
3. **Liability is unlimited :** The sole proprietor's liability is unlimited and his personal assets are liable to be attached for the payment of business liabilities. Because of this, the owner is discouraged from

expanding his business even when there are prospects for earning more than he has been doing.

4. **Lack of continuity**: Uncertain future is another handicap of this type of business, if the sole proprietor dies, his business may come to an end. Because of this, there is no security for the employees and also long term stability cannot be achieved.
5. **No economies of largescale** : As the proprietory concern is of a small scale size, the owner cannot secure the economies of large scale manufacturing buying and selling. This may raise the cost of prodution.

4.4.5 Suitablility of sole proprietorship form

From the discussion of the advantages and disadvantages of sole proprietorship above, it is clear that this form of business organisation is most suited where :

a) the amount of capital is small;
b) the risk involved is relatively low;
c) the nature of business is simple in character requiring quick decisions to be taken;
d) direct contact with the customers is essential;
e) the size of demand is not very large.

These conditions are satisfied by various types of small business such as retail shops, legal or medical or accounting profession, tailoring, service like dry cleaning or vehicle repair etc. hence, sole proprietory form of organisation is mostly suitable for these lines of business.

Check your progress-2

What is unlimited liability ?

4.5 JOINT HINDU FAMILY FIRM

4.5.1 Meaning

The Joint Hindu Family firm is a firm belonging to a joint Hindu family. It comes into existence by the operation of law.

In Hindu Law, there are two schools, viz., a) Dayabhaga which is applicable in Bengal and Assam, and b) Mitakshara which is applicable in the rest of India. According to Mitakshara school, the property of the Joint Hindu family is inherited by a Hindu family from his father, grand father and great grand father. Thus three successive generations in the male line (son, grandson and great grandson) can simultaneously inherit the ancestral property. They are called Coparceners-in-interest and the senior most member of the family is called 'Karta'. The Hindu Succession Act, 1956, has extended the line of co-parcenary interest to female relatives of the deceased co-parcener or male relatives claiming through such female relatives. Under the Dayabhaga Law, the male heirs become members only on the death of the father.

4.5.2 Features

Some of the important features of the Joint Hindu Family firm are as follows :

1. The business is generally managed by the father or some other senior member of the family and he is called Karta or Manager.
2. Except the Karta, no other member of the family has any right to participate in the management of a Joint Hindu Family firm.
3. The other members of the family cannot question the authority of the Karta and their only remedy is to get the family dissolved by mutual agreement.
4. If the Karta has misappropriated the funds of the business, he has to compensate the other co-parceners to the extent of their share in the joint property of the family.
5. For managing the business, the Karta has the power to borrow funds, but the other co-parceners are liable only to the extent of their share in the business. In other words, the Karta's liability is unlimited.
6. The death of any member of the family does not dissolve the business or the family.

7. Dissolution of Joint Hindu family can take place only through mutual agreement.

4.5.3 Advantages

The following are some of the advantages of the Joint Hindu family firm :

1. The existence of the Joint Hindu family firm does not come to an end with the death of any co-parcener. Hence, there is stability.
2. There is scope for younger members of the family to get the benefit of the knowledge and experience of the elder memebers of the family.
3. The Karta has full freedom to run the business without any interference by the other members. Hence, he can take business decisions without the interference of others.
4. As the Karta's liability is unlimited, be takes the maximum interest in running the business.
5. Members of the family who are unable to work because of sickness, old age, etc., are looked after by the other members of the family.
6. By assigning the work to the members as per their knowledge and experience, the benefits of specialisation and division of work may be secured.
7. The firm provides an opportunity to its members to develop the virtues of discipline, self-sacrifice and co-operation.
8. When compared to sole proprietorship, the credit worthiness of the family business is definitely more than that of the former.

4.5.4 Disadvantages

The Joint Hindu Family firm suffers from certain disadvantages such as the following :

1. As the benefit of the hard work of some members is shared by all the members of the family, there is no encouragement to work hard.
2. The Karta takes the responsibility to manage the firm. This may result in the other members of the family becoming lazy and inactive.
3. The Karta alone has full control over the business and the other members cannot interfere with the management of the firm. This may hamper the members' initiative.
4. The life of the business is shortened if family quarrels take precedence over business interests.
5. There is scope for the Karta to misuse his full freedom in managing the business for his personal benefits.

Conclusion

This form of business organisation which at one time was quite popular in India is now losing its popularity. The main cause for its decline is the gradual dissolution of the Joint Hindu family system. It is being replaced either by sole proprietorship or partnership firm.

4.6 SUMMING UP

There are various forms of business organisations of which each business is destined to follow any one form. The various forms of organisations are 1. Sole proprietorship; 2. Joint Hindu Family; 3. partnership firm; 4. Company form; and 5. Cooperative forms of organisation of all these organisations, sole proprietorship and Joint Hindu Family form of organisations are termed as traditional forms of organisations.

The selection of any form of organisation depends on many aspects and at the sametime it should possess certain characteristics. They are simplicity, mobilisation of capital, flexibility of operation, limit to liability and continuity in its operations.

The sole tradership is a traditional form of organisation. It is managed by a single person and he bears the responsibility for the profits and risks arising out of the trade. Though there are many advantages of sole trading business, there are a few short comings too. They are, limited resources, unlimited liability and there are no large scale economies. In the light of the above disadavantages, it has become imminent to invest in another form of organisation i.e., Joint Hindu family form of organisation. This form of organisation belongs to all the members of the Joint Hindu family and it comes into existence by operation of law. The three successive generations, i.e., son, garnd son and great grand son can simultaneously inherit the ancestral property. The senior most member/head of the family is called 'Karta'.

The karta of the family will manage the whole business. Karta has full powers as regards the business and he undertakes unlimited liability to organise the business. There is scope for younger people to become members of this business and get the experience from elder people. The credit worthiness of this form of organisation is more than the sole proprietorship and the Joint Hindu family form of organisation gives an opportunity to its members to develop qualities of discipline, self sacrifice and cooperation. In view of the problems that are faced by this form of organisation it gets dissolved and it is being replaced by the partnership form of organisation.

4.7 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Sole Proprietorship
   ii) Joint Hindu Family Firm
   iii) Partnership
   iv) Joing Stock Company
   v) Cooperative Society

2. The liability which extends to the personal assets of an individual apart from his share of contribution.

4.8 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. Set out the important factors to be considered while choosing a form of organisation for a business.
2. Discuss the scope and prospects of sole proprietorship form of organisation in India.
3. Explain the features of the Joint Hindu Family firm.
4. Explain the advantages and disadvantages of the Joint Hindu Family Firm.

B. SHORT QUESTIONS

5. **State the forms of business organisation**
6. **Mention the characteristics of an ideal form of organisation.**
7. **Define unlimited liability**
8. **What is a Joint Hinud family firm ?**

4.9 RECOMMENDED BOOKS

Krishnaswami OR	: 'Essentials of Commerce, Eagle Press Publication Division, Madras 1978.
Reddy P.N and Gulshan S.S	: 'Principles of Business Organisation and Management' S. Chand & Co., Ltd., New Delhi 1981.
Singh Avtar	: 'The Law of partnership' Eastern Book Company Lucknow 1973.

4.10 GLOSSARY

Joing Hindu Family Firm	: A firm belonging to a Joing Hindu Family governed by Hindu law.

Sole Proprietor ship	: A form of business organisation owned and managed by a single person
Unlimited Liabilities	: If the assets of the partnership firm are insufficeint to satisfy the claims of the creditors of the firm, even the personal property of the partners can be attached to meet such claims.
Unlimited Liability of Sole Proprietor	: The owner is liable to pay the debts of the business to the fullest extent even out of the private property.

UNIT-5 : PARTNERSHIP

Contents

5.0 AIMS AND OBJECTIVES

This unit covers a detailed note on partnership form of organisation and at the end of this unit, you come to understand

- the definition and elements of a partnership
- the features of partnership
- the kinds of partners
- the partnership agreement
- powers and duties of partners and the evaluation of partnership form of organisation

5.1 INTRODUCTION

The previous unit covers the traditional forms of organisation and this unit deals with 'Partnership' form of organisation. It covers a varied range of items regarding the features of partnership, kinds of partners, partnership agreement and the duties and powers of partners.

5.2 DEFINITION AND ELEMENTS OF PARTNERSHIP

5.2.1 Definition

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

5.2.2 Elements of Partnership

The following are the elements of Partnership

1. **Plurality of persons :** For consisting a partnership, there must be an association of two or more persons.
2. **Contractual relationship :** The partnership is created by an agreement between persons

a) the right of a partner to sue for dissolution of the firm or for accounts, and his share in the dissolved firm.
b) the power of an Official Assignee to realise the property of an insolvent partner.
c) suits not exceeding Rs. 100/-
d) suits arising in respect of anything other than under a contract; for instance, a suit against third party for infringement of the trade marks of the firm can be filed.

5.6 PARTNERSHIP AGREEMENT

5.6.1 Agreement/Deed

A partnership can be formed either by oral or written agreement. But in order to avoid misunderstanding and undesirable litigation, generally the partners enter into a written agreement. When it is registered, it is called a 'Partnership Deed'. It is not a public document like a Memorandum of Association of a Company and only binds third parties in so far as they have notice of it. It is stamped according to the provisions of the Stamp Act. Each partner is given a copy of the Deed.

5.6.2 Contents of the Partnership Deed

The Deed generally contains the following particulars :

1. Name of the firm;
2. Nature of business;
3. The town and place where business will be carried on;
4. Details concerning the amount of capital contributed by each partner;
5. Details relating to the sharing of profit and losses;
6. Loans and advances by partners and the interest payable on them;
7. The amounts that can be withdrawn by partners and the rate of interest;
8. The duties, power and obligations of the partners;
9. Maintenance of accounts and arrangement for audit;
10. Salary, if any, payable to any partner for managing the firm;
11. Rate of interest, if any, allowed on capital;
12. The method of valuation of goodwill on admission or death or retirement of a partner;
13. The method by which a partner may retire and the arrangement for the payment of the dues of a retired or deceased partner;
14. Method of revaluation of assets and liability on admission or retirement or death of a partner;
15. Arrangements in case a partner becomes insolvent;
16. Arbitration in the case of disputes among partners;
17. Settlement in the case of dissolution of partnership;
18. Any other clause or clauses which may be desired in any particular kind of business.

Check your progress - 2

What is partnership deed ?

5.7 RIGHTS, OBLIGATIONS AND POWERS OF PARTNERS

Generally, a Partnership Deed defines the rights and obligations of the partners. In case the

Deed is not prepared, the provisions of the Partnership Act apply. Even if the Deed is prepared and if it is silent on any point, the relevant provision of the Partnership Act applies.

5.7.1 Rights of a partner

Some of the important rights of a partner are as follows :

1. He has a right to share equally in the profits of the firm or as per any other proportion specified in the agreement.
2. He has a right to take part in the management of the firm.
3. He has the right to inspect books and copy from any other books of the firm.
4. In case he has given a loan to a firm over and above his capital, he is entitled to an interest rate of 6% per annum on such loan.
5. He has a right to express his opinion on the matters related to the firm. Though ordinary matters are decided by the majority vote of the partners, no change can be made in fundamental matters without the consent of all the partners.
6. In case he has made any payment or incurred any losses in the conduct of the business, he has a right to be indemnified by the firm.
7. He has a right to retire according to the provision of the Partnership Deed or with the consent of the other partners.
8. He has the right to continue in the firm unless he is expelled by the other partners in accordance with the provisions of the partnership deed.

5.7.2 Obligation of the partners to the firm and to one another.

The following are his obligations :

1. Every partner should share the losses of the firm equally with other partners unless otherwise agreed upon.
2. All partners of the firm must be just and faithful to one another.
3. In case any partner earns a profit for himself by making use of the firm's property or name, he should pay it to the firm.
4. If the firm incurrs any loss because of the negligence of any partner, he should indemnify the firm for such a loss.
5. Every partner must make every efforts to prevent the firm from incurring any loss to the best of his ability.
6. Every partner must maintain correct accounts of the firm and should not prevent other partners from inspecting the accounts.
7. Every partner must act within the scope of the authority given to him by the Partnership Deed and in case he exceeds his power, he must indemnify the firm.
8. No partner can transfer his interest in the firm to a third party without getting the consent of all the other partners in the firm.

5.7.2 The Partner's liabilities to third parties

1. The partners are jointly and serverally liable for all the debts of the firm. The creditors of the firm can file a suit in the court either against any one or all of the partners. In case the assets of the firm are not sufficient to clear the firm's debts, the personal properties of individual partners are liable to be attached for the payment of the debts of the firm.
2. A partner who is retiring is also liable for the firm's debts incurred while he was a parter. But if there is any express agreement with the credits and other partners to absolve him, he can be free from the liability.
3. The firm is liable to make good the loss to any third party who has been made to incurr loss by a partner acting within the scope of his powers.

5.7.4 Power of Partners

In partnership business, every partner is the agent of the firm and his co-partner for the purposes of carrying on the business of the firm and each is bound by the other's act in carrying on the business. This authority of a partner to act on behalf of the firm may be either express or implied. In the case of express authority, the authority is expressly given to a partner by the partnership agreement. The firm is bound by all the acts related to business done by a partner by virtue of any express authority given to him.

Implied authority means, the authority which arises on account of the implication of law. By implied authority, the act of a partner which is done in connection with the business binds the firm provided that the act is done in the firm's name or in any manner expressing or implying an intention to bind the firm.

5.7.5 Implied authority of a partner

Every partner has a implied authority to bind the firm by the following acts :

1. He may sell the goods of the firm.
2. He may purchase the goods for the firm.
3. He may receive payment of debts due to the firm and issue valid receipts.
4. He may hire employees or remove employees of the partnership business.

In the case of trading firm (business involving only buying and selling of goods), a partner has the following additional powers :

1. He may accept cheques or issue cheques in the firm's name.
2. He may make bills of exchange and promissory notes in the firm's name.
3. He may borrow money on the firm's credit and pledge the firm's goods for the purpose.
4. He may employ an attorney on behalf of the firm.

5.8 EVALUATION OF THE PARTNERSHIP FORM OF ORGANISATION

5.8.1 Advantages

The following are the advantages of partnership as a form of business organisation :

1. **Ease of formation :** Partnership can be easily formed without expense and legal formalities. Even the registration of the firm is not compulsory.
2. **Large resources :** When compared to sole-proprietorship, the partnership will have larger resources. Hence, the scale of operations can be increased if conditions warrant it.
3. Better organisation of business : As the talents, experience, managerial ability and power of judgement of two or more persons are combined in partnership, there is a scope for a better organisation of the business.
4. **Great interest in business :** As the partners are the owners of the business and as profit from the business depends on the efficiency with which they manage, they take as much interest as possible in the business.
5. **Prompt decisions :** As partners meet very often, they take decisions regarding business policies very promptly. This helps the firm in taking advantage of changing business conditions.
6. **Balanced Judgement :** As partners possess different types of talents necessary for handling the problems of the firm, the decisions taken jointly by the partners are likely to be balanced.
7. **Flexibility :** Partnership is free from legal restrictions for changing the scope of its business. The line of business can be changed at any time with the mutual consent of the partners. No legal formalities are involved in it.
8. **Diffusion of risk :** The losses of the firm will be shared by all the partners. Hence, the share of loss in the case of each partner will be less than that sustained in sole proprietorship.
9. **Protection to minority interests :** In important matters like change in the nature of business, unanimity among partners is necessary. Hence, the minority interest is protected.
10. **Influence of unlimited liability :** The principle of unlimited liability helps in two ways. First, the partners will be careful in their business dealings because of the fear of their personal properties becoming liable under the principle of unlimited liability. Secondly, it helps the firm in raising loans for the business as the financiers are assured of the realisation of loans advanced by them.

5.8.2 Disadvantages

Against the advantages, there are disadvantages in the case of partnership form of organisation.

1. **Great risk :**

As the liability is joint and several, any one of the partners can be made to pay all the debts of the firm. This affects his share capital in the business and his personal properties.

2. **Lack of harmony :**
Some frictions, misunderstandings and lack of harmony among the partners may arise at any time which may ultimately lead to the dissolution of the partnership.
3. **Limited resources :**
Because of the legal ceiling on the maximum number of partners (10 in case of banking business and 20 in the case of any other business), there is a limit to the amount of capital that can be raised. This is a great handicap specially when it requires more capital for expansion.
4. **Tend to play safe :**
Because of the principle of unlimited liability, the partners tend to play safe and pursue unduly conservative policies.
5. **No legal entity :**
The partnership has no independent existence apart from that of the persons constituting it, ie., it is not a legal entity.
6. **Instability :**
The death, retirement or insolvency of a partner leads to the dissolution of the partnership. Further, even any one partner, if dissatisfied with the business, can bring about the dissolution of partnership. Hence, partnership lacks continuity.
7. **Lack of public confidence :**
No legal regulations are followed at the time of the formation of partnership and also there is no publicity given to its affairs. Because of these reasons, a partnership may not enjoy pulbic confidence.

5.8.3 Suitability

The advantages and drawbacks of partnership stated above suggested that the partnership organisation tends to be useful only for comparatively small businesses such as retail trade, mercantile houses of moderate size, professional services or small scale industries and agency business. But when compared to sole proprietorship, partnership is suitable for a business bigger in size and operations.

5.9 SUMMING UP

From the experience of sole tradership, and the Joint Hindu family form of organisations, it has been noticed that there are some difficulties/disadvantages in the functioning of these organisations. It was then found that the partnership form organisation would be better suited for marginal business.

The partnership organisation is nothing but an agreement between two or more persons to share the profits and losses among them. The formation of the partnership is very easy and the capital contribution will also be from among the partners. The liability is unlimited and there is no separate legal entity to this organisation. The control of the partnership is a Joint one by all the members. There are various kinds of partners. They are the active partners and sleeping partners. The partnership form of business has to be registered under the partnership Act of 1932 and there are more advantages in this business form. Apart from registration there is an agreement between these partners regarding their sharing of capital contribution, profit sharing and other terms of conditions.

5.10 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Plurality of persons
ii) Contractual relationship
iii) Profit sharing
iv) Existence of business.
v) Principal-agent relationship.

2. It is an agreement entered into by partners and it specifies the contribution rules and regulations of partnership.

5.11 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. Explain the essential features of Partnership.
2. Explain the rights and duties of partnership business.
3. What is a Partnership Deed? State its contents.

B. SHORT QUESTIONS

4. Define Partnership
5. What is unlimited liability?
6. What is 'express authority'?
7. What is 'implied authority'?

5.12 RECOMMENDED BOOKS

Krishnaswami OR : 'Essentials of Commerce.' Eagle Press Publication Division, Madras 1978.

Reddy P.N. and Gulshan S.S : 'Principles of Business Organisation and Management S. Chand & Co., Ltd., New Delhi, 1981.

Singh Avtar : 'The Law of Partnership EastrenBook Company Lucknow 1973.

5. 13 GLOSSARY

Partnership : The relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

Partnership Deed : An agreement entered into by partners. It specifies the constitution rules and regulations of the partnership.

BLOCK-III : COMPANY ORGANISATION

UNIT-6 : INTRODUCTION TO JOINT STOCK COMPANIES

Contents

6.0 AIMS AND OBJECTIVES

This unit deals with the definition and features of Joint Stock Company, you would understand at the end of this unit as to

- What is the definition of Joint stock company
- What are the features of Joint Stock Company
- What are the kinds of Companies
- Understand the merits and demerits of the company form of organisation

6.1 INTRODUCTION

The previous unit covers the partnership form of organisation at length, and this unit introduces the company form of organisation i.e., Joint stock company. It covers the meaning and features of Joint stock company, kinds of companies and the procedure of evaluation of Joint stock company.

6.2 DEFINITION AND FEATURES OF A JOINT-STOCK COMPANY

6.2.1 Introduction

Sole-proprietorship and partnership form of organisation could not meet the needs of modern industry and commerce because of their drawbacks like limited resources, unlimited liability etc. The need for another form of organisation free of the above mentioned drawbacks was felt and thus Joint Stock type organisation can raise large resources without the risk of unlimited liability. It is suitable for undertakings requiring large capital. This unit deals with its definition, features, types of companies and attempts a brief evaluation of this form of organisation.

6.2.2 Definition

Lord Justice of England has defined Joint Stock Company as 'an association of many persons, who contribute money or money's worth to a common stock and employ it for a common purpose. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute to it or to whom it belongs are members. The proportion of capital to which each member is entitled his share.'

According to Justice John Marshall of USA 'a Corporation (Company) is an artificial being, invisible, intangible and existing only in the contemplation of the law. Being a mere creature of the law, it possesses only those properties which the charter of its creation confers on it, either expressly or as incidental to its very existence'.

Companies Act (1956) of India defines Joint Stock Company 'as a company limited by shares having a permanent paid up or nominal share capital of fixed amount divided into shares, also of fixed amount held and transferable as stock and formed on the principles of having in its members only the holders of those shares or stocks and no other persons'.

A more comprehensive definition will, however, be one that indicates all the essential features of a company. Thus we may define a company as an artificial creature created by law, with a distinctive name, a common seal and perpetual succession.

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

1. It is created by law.
2. It has a separate legal entity.
3. It is an artificial being but invisible and intangible.
4. It is an association of many persons.
5. It has a distinctive name.
6. It has common seal as a substitute for signature.
7. Its liability may be limited.
8. It has perpetual succession.

6.2.3 Features of a Joint Stock Company

Some of the distinctive features of a company are as follows :

1. **Incorporated Association :** A Company comes into existence only after registration under the Companies Act whereas registration is not compulsory for other forms of business organisations like sole-proprietorship and partnership.
2. **Artificial legal person :** A company is a corporate body; it is an artificial person created by law. It enjoys all the legal rights of a natural person like the making of contracts, owning of property, etc.
3. **Distinct legal entity :** A company is regarded as an entity separate from its members. A share holder of a company can enter into contract with the company and can sue the company and be sued by it. The life of the company is independent of the life of its members.
4. **Common seal as a substitute for signature :** As the company is not a natural person, it cannot sign documents. The common seal with the name of the company engraved on it is, therefore, used in place of signature. Generally, the secretary of the company is authorised to keep the seal under his custody.
5. **Perpetuity :** A company has perpetual existence unlike a partnership or a sole trading concern. Once a company is formed, it continues for an unlimited period until it is legally dissolved. In otherwords, a company has an unending life and the death or insolvency of a shareholder does not affect its existence. The maxim that 'men may come and men may go out but I go on ever' applies to the company
6. **Limited liability :** The liability of the members of a company is normally limited by guarantee or by the shares. If a member has already paid the full amount due on his shares, he is not further liable towards the debts of the company and his personal properties are not liable to be attached for the payment of the company's debts. It may be stated here that in the case of Sole-proprietorship and partnership the liability is unlimited and in the case of the later, it is both joint and several.
7. **Number of members :** The maximum number of members in the case of a public limited company is unlimited, the minimum being seven, while in the case of a private limited company, the maximum is fifty excluding the employee members of the company and the minimum is two.
8. **Seperation of Ownership and Management :** A company is owned by the share holders, but it is managed by a separate body, called 'Board of Directors' elected by the share holders. We have seen in the case of partnership that every partner is an agent of the firm and also of the other members. But in the case of a company, a share holder is not an agent of the company

or other share holders and he cannot bind them by his acts.

9. **Rigidity of objects :** The scope of the business of a company cannot be changed and it cannot do any business not already included in the 'object clause' of its Memorandum of Association. A change in the 'object clause' can be effected after complying with the provisions of the Companies Act and only then any alteration in the scope of business can be made.
10. **Transferability of shares :** The share holder of a Public Limited Company is at liberty to transfer his shares to others without the consent of other shareholders. For transferring the shares the only thing he has to do is to follow the procedure laid down in the Companies Act. In a Private Company, however, some restrictions are imposed for transferring shares.
11. Financial resources : In the case of a company, there is a great scope for mobilising a large capital because of the principles of limited liability and diffusion of ownership.
12. **Statutory regulations :** A company has to comply with the numerous and varied statutory requirements. A company is governed by the Companies Act and it has to follow the various provisions of the Act. It has to submit a number of returns to the Government and also its accounts have to be audited by a Chartered Accountant.

6.3 KINDS OF COMPANIES

Companies may be classified with reference to

6.3.1 mode of incorporation;
6.3.2 type of liability; and
6.3.3 the category of share holders.

6.3.1 Mode of Incorporation : Companies can be incorporated in three ways, namely, i) by charter, ii) by statute and iii) by registration.

i) **Chartered Company**

If a company is incorporated under a special Royal Charter granted by the Monarch, it is called a 'Chartered Company' and it is regulated by the provisions of that Charter. For example, the East India Company, the Chartered Bank of Australia, India and China were incorporated by the grant of a special Royal Charter. In India, this form of organisation does not exist now because there is monarchy.

ii) **Statutory Corporation**

A corporate body which is established by a special Act of the Parliament is called a 'Statutory Corporation' and it is governed by the provisions of such an Act. This is done only in special cases where it is required to regulate the functioning of the company for some specific purposes. Examples of such corporations in India are the Life Insurance Corporation of India, Air India Corporation, Industrial Finance Corporation, the State Bank of India, State Trading Corporation, Food Corporation of India, etc.

iii) **Registered Company**

A company which is established through registraion with the Registrar of Companies under the Companies Act (1956), is called a 'Registered Company'. Most of the companies belong to this category.

6.3.2. Type of Liability : With reference to liability, companies may be classified as i) companies with unlimited liability, ii) companies with liability limited by guarantee and iii) companies with liability limited by shares.

i) **Companies with unlimited liability**

In this type of company, the liability of members is unlimited as in the case of individual proprietorship or partnership. The members can be called upon to pay an unlimited amount even from their personal property to discharge the debts and liabilities of the company when it is wound up.

ii) **Companies with liability limited by guarantee**

In this case, each member gives guarantee for the debts of the Company up to a certain extent in addition to the amount of shares held by him. The additional amount payable by the member is laid down in the Memorandum or Articles of Association. This type of company is formed mostly when the business is of a non-profit making nature and has the object of promoting social and cultural activities. Chambers of Commerce, Trade associations, Clubs, Societies and Charitable organisations can be registered as this type of company.

iii) Companies with liability limited by share

In this case, the liability of members is limited only to the amount of the shares held by them. It means, that a member can be called upon to pay only the unpaid amount on shares purchased by him. For example, a shareholder, who has paid Rs. 5/- on a Rs. 10/- share, can be called upon to pay the balance of Rs. 5/- and nothing more. Most of the companies are of this type.

6.3.3. Category of Shareholders : From this point of view, the companies may be classified as i) Private Companies, ii) Public Companies.

i) Private Company

Definition :

A Private Company is a company which requires a minimum number of two persons for registration and which by its articles a) limits the maximum number of its members to 50 excluding its employees, b) Restricts the transfer of its shares from one shareholder to another; and c) prohibits invitation to the public to subscribe to its shares and debentures.

The Private company suits such persons who wish to have the advantages of limited liability, while at the same time keeping the business as private as possible. Even though there are certain similarities between Private company and Partnership, many businessmen prefer the Private company form of organisation because of its advantages of limited liability and corporate entity, and legal privileges.

Privileges of a Private company : Private Companies enjoy certain privileges which are not allowed to a Public company. The various privileges of a private company are :

1. Two members are sufficient to form a private company.
2. It is not necessary to file with the Registrar either a prospectus or a statement in lieu of prospectus.
3. It is allowed to start business immediately after Registration and there is no need to secure a certificate to commence business.
4. It need not hold the statutory meeting and need not file statutory report with the Registrar.
5. Two directors are sufficient though more can be appointed if the company is so inclined.
6. The approval of the Government for granting loans to directors is needed.
7. Many of the restrictions laid down on the allotment of shares of public companies are not applicable to the private companies.
8. Just two members can make a quorum for its meetings.
9. Thre is no restriction regarding the term of appointment of managerial personnel.
10. There is no restriction on the remuneration payable to directors and manage...al personnel.
11. There is no need to keep an index of its members.
12. Restrictions on the issue of shares with disproportinate voting rights are not applicable to private companies.
13. Provision regarding the issue of further shares, first to the existing equity shareholders, does not apply to a Private company.
14. Restrictions on investment in other companies under the same management do not apply to private companies.
15. No person other than a shareholder of the private company is entitled to inspect or obtain copies of the 'Profit and Loss account' and the Balance Sheet filed with the Register.
16. Provisions regarding the Central Government's power to prevent changes in the Board which are likely to affect the companies prejudicially are not applicable to a private company.

Limitations of a Private Company : The law as pointed out places three restrictions on a private company namely, restriction on the maximum number of members which it could have, restriction on transfer of shares and prohibition of an invitation to the Public to subscribe to its shares and debentures. These restrictions impose certain constraints on the growth and expansion of its business. In that case, the remedy, lies in converting itself into a public company.

ii) Public Company

A public company means a company which is not a private company. The minimum number of members required to start it is seven and there is no maximum limit. It can invite the public to subscribe to its shares wich are transferable. It must have atleast 3 directors to commence its business and must also obtain a certificate to commence business from the Registrar of Companies.

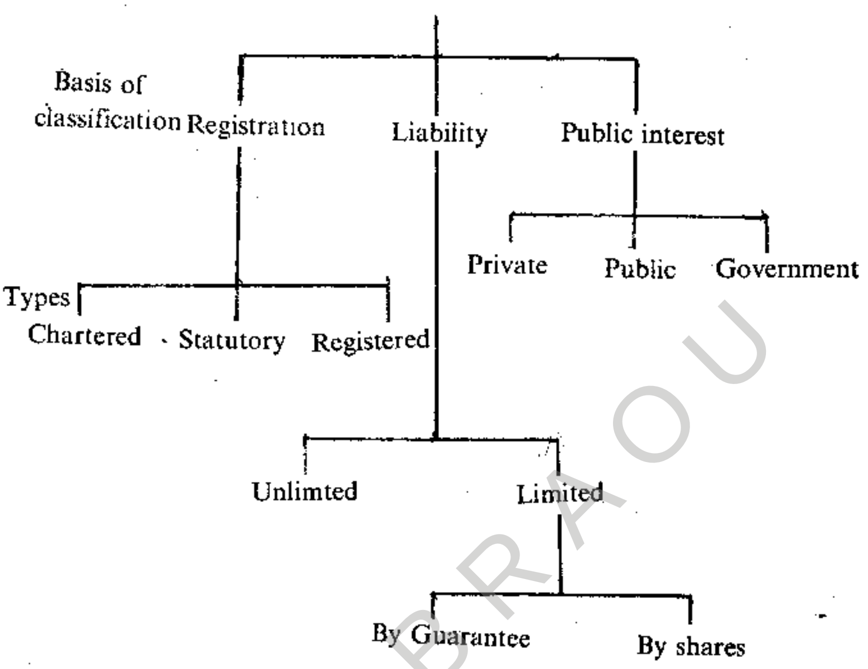
iii) Government Company

A Government company is a company in which not less than 51% of the paid-up share capital is held by the Central Government and or by the State Government or Governments or jointly by the Cetnral and State Governments. The remaining 49% of the paid-up capital may, threfore, be held by private parties or financial institutions.

The following chart indicates the different kinds of Companies.

Chart 3

KINDS OF COMPANIES



Check Your progress-1

What are bases for the classification of companies?

6.4 ADVANTAGES AND DISADVANTAGES

The Company form of organisation has become very popular throughout the world. This is due to the many advantages which the company organisation enjoys over other forms of organisation.

6.4.1 Advantages

The Chief advantages of the company form of organisation are as follows :

i. Financial Strength : A company can raise large amounts of capital by issuing shares and debentures to the public.

2. **Limited Liability :** A company can adopt the principle of limited liability. According to this principle, a share holder's liability is limited to the extent of the face value of the shares held by him or guarantee given by him and his perosnal properties are not affected even if the company goes into liquidation. This is a great attraction to investors.
3. **Benefits of large scale organisation :** A Company can organise a large enterprise and can offer goods and services to the public at low prices as a result of the economies of large scale operation.
4. **Scope for expansion :** As there is no limit to the maximum number of members which a public company can have, there is a great scope for increasing the resources of the company for the expansion of the business. A prosperous company can build up services for financing its expansion or modernisation.
5. **Diffused risK :** The risk of each member is reduced because it is diffused and spread over several members of the company. This is an advantage for the individual investor.
6. **Transferability of shares :** The shares of a public company are freely transferable from one person to another for which the consent of other shareholders is not necessary. The shares of a company can be sold at any time in the Stock Exchange and this is an added attraction to the investors.
7. **Stability :** A company enjoys perpetual succession, as the retirement or death of a shareholder does not affect the company.
8. **Efficient Management :** In a company organisation, there is considerable scope for efficient management. Efficient persons may be elected directors and, if found inefficient they may be changed in the next meeting. Normally, the directors have a great stake in the business. Hence, they have to be efficient. Further, the company is in a position to get the services of the most talented persons and specialists. This also helps the company in managing its business efficiently as professional competent managers can be recruited by the Company.
9. **Tax relief :** Companies get tax advantages when profits are large because the system of corporate taxation is 'flat' and not progressive.

6.4.2 Disadvantages

Nevertheless, the company form of organisation suffers from some drawbacks and limitations. They are as follows :

a) **Formation is difficult:** The promotion of a company is a long-drawn out process. Various legal formalities have to be carried out, involving heavy expenses. Because of these difficulties, many people are dissuaded from starting Companies.
b) **Lakc of personal interest :** A company is managed by paid executives and not by shareholders. Hence, the paid executives may not have a personal interest in the management of the company, as they have no financial stake in it. This may result in inefficiency.
c) **Excessive government control :** The company form of organisation is subject to considerable Governement regulation and it has to spend considerable time and effort in complying with the various legal requirements.
d) **Lack of prompt decision :** The major policies have to be decided by the Board may consist of diverse interests which may lead to disagreement, etc. Hence, prompt decisions are not possible in the company form of organisation.
e) **Lack of secrecy :** The details of operations and transactions and results have to be furnished to the shareholders and filed with the Registrar of Companies. Hence, it is not possible to maintain business secrecy.

From this discussion of the advantages and disadvantages of the company form of organisation, it may be concluded that the advantages considerably outweigh thedisadvantages. Now the company form of organisation has become universally popular and well-established in the business world. It is best suited to those lines of business activity which require a huge capital outlay and maximum stability.

Check your progress -2

What is a diffused risk?

6.5 SUMMING UP

In the process of analysing the different forms of organisations it is found that the joint stock companies would play a very important role in the economy of any country. In this unit,a description of joint stock company is given. The features of Joint stock company are analysed in the beginning. The Joint stock company is an association and it is an artificial legal person. It has continuous existence with limited liability and it has more finanical resources. After this, different kinds of companies based on different charcteristics are given, finally, it has been explained that the companies are divided into two types : (i) Pubilc Company and ii) Private Company. There are both advantages and disadvantages of public and private companies. Depending on the need and nature of the situation, these companies are formed into private or public companies. In the present day circumstances, many people are going to public companies because of many advantages in this form of organisation. Inspite of the disadvantages there are many advantages of public companies, as many of the benefits are given by Government. Thus the company form of organisation is universally popular and has become established in the business world.

6.6 CHECK YOUR PROGRESS : MODEL ANSWERS

1. a) Mode of incorporation;
   b) type of liablility; and
   c) the category of share holders;
2. The risk of each members is reduced because it is diffused and spread over several members of the company. It is an advantage for the individual investor.

6.7 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. Explain the features of 'a Joint Stock Company'.
2. Explain the advantages and disadvantages of the Joint Stock Company form of organisation.
3. What is private company? What are the various privileges enjoyed by it?

B. SHORT QUESTIONS

4. Define 'Joint Stock Company'
5. What is a Private Company?
6. What is a Government Company?
7. What is the meaning of 'Companies with limited liability by shares'?
8. What is the meaning of 'Comapnies with liability limited by guarantee'?
9. What is Chartered Company?
10. What is a Statutory Company?

6.8 RECOMMENDED BOOKS

Krishnaswami OR : 'Essentials of Commerce'
Eagle Publication Division , Madras 1981

Pattanshetti CC and Reddy PN : 'Company Secretarial Practice'
Mc. Gra Hill Pulishing Co. Ltd., New Delhi, 9181.

Reddy PN and Gulshan SS	:	'Principles of Business Organisation and Management S. Chand and Co. Ltd. 'New Delhi
Bhushan Y.K.	:	**1981 "Fundamentals of Business Organisation and Management Sultan Chand & Sons New Delhi-110 002**

6.9 GLOSSARY

Board of Directors	:	The Directors of a company are collectivley known as the Board of Directors.
Government Company	:	A company in which not less than 51% of the paid-up share capital is held by the Central Government and/or by State Government or Governments or jointly by the Central and State Governments.
Joint-Stock Company	:	An artificial person, created by law, with a perpectual succession and a comon seal.
Limited Liability	:	The liability of the members as regards the debts of their company is limited to the face value of the share subscribed by each of them or to the guarantee given by them.
Registered Company	:	A company registered with the registration of companies under the companies Act, 1956.

UNIT-7 : COMPANY INCORPORATION

Contents

7.0 AIMS AND OBJECTIVES

In this unit, we introduce the procedure for the incorporation of a company, release of prospectus and how the company starts its business.
By the end of this unit, you will come to know
- procedure of incorporating the company ,
- the different aspects involved in the release of prospectus.
- the meaning of allotment of shares
- the procedure involved in getting the certificate of commencement of business.

7.1 INTRODUCTION

This unit is a comprehensive account of a company's incorporation and commencement of business. In this unit, the memorandum of association. Articles of association, prospectus are studied. Afterwords, the procedure for allotment of shares and how the certificate of commencement of business is obtained are also studied.

7.2 INCORPORATION OF COMPANY

7.2.1 Incorporation

It is essential for some persons to take responsibility to bring a company into existence. The persons who take up this responsibility are known as 'promoters'. Promotion work to be done by the promoters involves discovery of specific business opportunities, study of their feasibility, establishment of a form of organisation, mobilisation of resources etc, (see unit 3 for details)

The work of promotion of a compnay involves four stages. They are :

1. Discovery of a business proposition and making a preliminary study to find out whether it is worthwhile to make a detailed investigation.
2. Making a detailed investigation of the proposition with the assistance of experts like Engineers, financial experts, etc., to determine its technical feasibility, economic viability and profitability.
3. Preparation of project report including financial planning.
4. Preparatory work - this involves selection of site, securing the approval of building plan,

licence etc.

After completing the various stages of promotion, the promoters have to take steps to get the company incorporated. For this purpose, the following documents have to prepared and filed with the Registar of Comapnies of the State in which the Registered Office of the company is to be situated:

1. **The Memorandum of Association :** At least seven persons, each promising to take up atleast one share must subscribe their names to the Memorandum.
2. **The Articles of Association :** This also has to be similarly signed except where Table-'A' attached to the Companies Act 1956 has been adopted as the Company's Articles.
3. A list of proposed Directors with particulars of their names, addresses, occupations and age.
4. Consent in writing of the proposed Directors to act as Directors.
5. An undertaking by the Directors stating that they have agreed to purchase and pay for the prescribed qualification shares.
6. A statement of nominal capital and in case it exceeds Rs. 50/- lakhs, a certificate from the Controller of Capital Issues.
7. A statutory declaration by an advocate or by a Chartered Accountant or by a person named as Director or any person who has taken part in the formation of the company stating that all the provisions of the Companies Act with regard to registration have been complied with.
8. Proof of payment of the prescribed registration fee.

If the Registrar is satisfied with these documents he will issue a certificate of incorporation.

The certificate of incorporation which is dated and signed by the Registrar is a proof of the fact that the company has been incorporated under the Companies Act.

7.2.2 Memorandum of Association

The Memorandum of Association is the most important document of the Company. It is its charter. It lays down the objectives of the company, defines the scope of its operation and its relation with the investors and the outside world. The company has to work within the limits laid down in the memorandum.

The memorandum has to be divided into paragraphs and consecutively numbered and printed. It must be signed by every one of the seven subscribers with their full addresses.

Contents of the Memorandum : Memorandum of Association contains the following clauses :

1. **Name Clause :** it contains the name of the company. The name selected should not be similar to or identical with that of any other existing company. Further, the name should not be one which is considered undesirable by the Central Government. The name of the company should end with the word, 'limited'. If it is a private company, it should end with the words 'Private Limited'.
2. **Situation Clause :** In the clause, the name of the state in which the registered ofice of the company is to be situated is stated.
3. **Object Clause :** This clause specifies the objects for which the company is formed. As it is difficult to alter the object clause later on, it is necessary that the promoters should draft this clause carefully and include in this clause, all possible types of business in which a company may engage in future. The object clause must contain :

   a) the main objects of the company and objects incidental or ancillary to the attainment of the main objects;

   other objectes of the company
4. **Liability Clause :** This clause states that the liability of members is limited to the unpaid amount of the face value of the shares held respectively by them.
5. **Capital clause :** This clause mentions the total amount of capital called 'authorised capital' with which the company is to be registered. The type of shares, their number and denominations are also mentioned.
6. **Association or Subscription clause :** This clause contains a declaration by the subscriber to the Memorandum and reads as follows : "We the several members, whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of this Memorandum of Association and we respectively agree to take the number of shares in the capital of the company mentioned opposite our respective names."

Alteration of the Memorandum of Association : The following clauses of Memorandum can be altered by following the procedure prescribed by the Companies Act :

1. **Alteration of name clause :** Name clause can be altered by passing a special resolution and obtaining the approval of the Central Government. However, if a company is registered inadvertently under a name identical with that of an existing company, the alteration requires an ordinary resolution and the consent of the Central Government.
2. **Alteration of domicile clause :** This can be changed in the following manner :

a) by a special resolution and the sanction of the court for shifting the Registered Office from one State to another;

b) by only a special resolution for shifting the office within the State;

c) by an ordinary resolution for shifting the office from one locality to another in the same town.

3. **Alteration of object clause :** This can be done by passing a special resolution and securing the sanction of the Company Law Board.
4. **Alteration of capital :** This can be affected by passing as ordinary or special resolution as provided in the Articles of the Company except with regard to reduction of capital, in which case the company must pass a special resolution and obtain confirmation by the court.

Check Your Progress-1

Name the different clauses in the Memorandum of Association?

7.2.3 Articles of Association

The Articles are the internal regulations of the company on the basis of which its internal affairs are managed. It lays down the powers of the Director, shareholders and officers of the company. It also contains rules and regulations regarding the following :

Articles should not contain anything which goes against the Memorandum and if it does contain any such, it will not have any affect as the Articles are subordinate to the Memorandum.

Articles should be printed and divided into paragraphs and signed by each subscriber to the Memorandum and filed with the Registrar.

The preparation of Articles by a Company limited by shares is not compulsory. In case the Articles are not prepared, the company must adopt the regulations contained in Table-A of the Companies Act. It may be noted here that a private company cannot adopt Table-A of the Act. It should have its own Articles.

Alteration of Articles : Articles can be altered by a special resolution. However, if any alteration is unfair or inequitable between the members or contains something illegal, the court can disallow such alteration. Further, the altered articles should not exceed the powers of the company as given by the Memorandum.

7.2.4 Effects of Memorandum and Articles : The Memorandum and Articles, when registered, bind the company and members thereof to the same extent as if they had been signed by each member. These two documents are public documents and so are open to inspection by any person intending to deal with the Company. Hence, a person dealing with a company is considered to have full knowledge of the articles of that company.

7.2.5 Differences between Memorandum and Articles : The differences are as follows :

1. The Memorandum is the fundamental charter of the company while the Articles are subordinate to that charter.
2. The Memorandum defines the objects and powers of the company whereas the Articles are the byelaws of the company for the conduct of its internal administration. Further, as Articles are subordinate to the Memorandum, it cannot provide anything contrary to the powers and objects stated in the Memorandum.
3. Preparation and filing of Memorandum with the Registrar are complusory for getting the company incorporated whereas the preparation of Articles is not compulsory. If any company does not prepare Articles, the Table-A of Companies Act is applicable to such a company.
4. The Memorandum cannot be altered easily. It requires a special resolution and the sanction of the court or the Central Government or the Company Law Board, as the case may be,

whereas the Articles can be altered by a special resolution and without any such sanction.

5. Memorandum defines the relationship between the company and outsiders, whereas the Articles define the ralationship between the members and the management of the company. It mainly provides rules and regulations for the internal working of the Company.

7.3 PROSPECTUS

7.3.1 Meaning : After the incorporation of the company, if the promoters want to invite the public to subscribe to its shares or debentures, they have to prepare and issue a document known as 'Prospectus' with the necesary information. The Companies Act defines 'prospectus' as 'any doucment described or issued as a porspectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures or a body corporate'.

7.3.2 Main object of Prospectus : The main objects of the Prospectus are :

a) to inform the public about the new company that is being formed;
b) to induce investors to invest their funds in the company;
c) to preserve an authentic record of the terms on which the investors have been invited;
d) to make the Directors responsible for the statements in the Prospectus.

7.3.3 Statement in lieu of prospectus : If the Company manages to get capital without public subscription, there is no need for it to issue a prospectus and instead, it can prepare a statement in lieu of Prospectus containing almost similar information and file it with the Registrar.

7.3.4 Legal provisionsregarding the issue of prospectus : The Prospectus must be prepared carefully and it should not contain any untrue statement or mislead the public. If any person has purchased shares or debentures from a company on the basis of untrue statements in the Prospectus, he can cancel the contract and also claim damages from the promoters, Directors or any other person who has authorised the issue of the Prospectus.

Persons issuing the prospectus are liable to criminal action for giving untrue statements. Thus every person who authorises the issue is liable for punishment with imprisonment upto two years or with fine not exceeding Rs. 5000/- or with both.

However, several defences are open to the person who authorises the issue of Prospectus with untrue statements. Some of the defences are as follows :

a) that he has a reasonable ground to believe that the statements are true;
b) that it was issued without his knowledge or consent and that on becoming aware of it, he gave public notice;
c) that he withdrew his consent to become a director;
d) that after becoming aware of the false statement, he withdrew his consent to the issue and gave public notice thereof.

7.3.5. Contents of prospectus : The important contents of prospectus are as follows :

1. Contents of Memorandum;
2. Nature of the business of the Company;
3. Details regarding the persons who have signed Memorandum and number of shares subscribed by them;
4. Classes of shares in which the share capital is divided together with their totals;
5. Rights attached to each class of shares;
6. If debentures are issued, details regarding their issue;

   Particulars about the Directors, Managing Director and their remuneration, powers etc;
8. Particulars relating to preliminary expenses;
9. The minimum subscription;
10. Time of the opening of the subscription list;
11. The amount of premium or discount on shares;
12. Property of vendors to be sold to the company;
13. The amount payable as consideration to the promoters for floating the company;

14. Particulars regarding capitalisation of reserves or profits;
15. The amount payable alongwith application, and on allotment on each class of share;
16. Names of the underwriters and the opinion of the Directors that the resources of the underwriters are sufficient to discharge their obligations;
17. Names and addresses of auditors, bankers and solicitors;
18. Share qualification, if any, of a Director;
19. In the case of an existing company, a report of the auditors about its performance;
20. A Statement regarding the filing of the Prospectus with the Registrar.

7.3.6 Points to be considered by a Prospective investor; Since the Prospectus is issued to the public with the intention of persuading investors to invest their funds in the Company. The following are the points to be considered by a prospective investor for arriving at a decision to invest his funds in the company:

a) Nature of business and its prospects;
b) Objectives of the company : He has to know whether they are too ambitious and whether they can be achieved under the existing conditions;
c) Standing and reputation of promoters and Directors of the Company;
d) Nature of contracts entered into by the Company;
e) **Capital structure** : he should find out whether the capital proposed to be raised is adequate and whether the proportion between various classes of shares and their voting rights is acceptable.
f) Past history of the concern if any;
g) Purchase considerations for properties acquired for the Company;
h) Terms of underwriting and the reputation of underwriters;
i) Standing of the company, bankers legal advisers and auditors of the Company.

After considering the above mentioned points, if the prospective investor is satisfied, he may take a decision to apply for the shares.

Check Your Progress-2

What is meant by Statement in lieu of prospectus?

7.3.7. Application and Allotment of Shares

The Companies Act provides that all application forms should be issued along with the Prospectus and usually the public is requested to send the application to the Company's bankers. After the closure on the last day for the receipt of applications the banker forwards the applications to the company. An allotment to be valid must fullfil the following conditions.

A) It should be passed by a resolution at the Board of Directors meeting within a reasonable time from the date of application;
B) The Prospectus or a statement in lieu of Prospectus must be filed with the Rigistrar;
C) Subscriptions to the extent of minumum subscription must be made or applied for;
D) At least 5 percent of the nominal value of the shares must be received by the company and the same must be deposited in a scheduled bank.

If the allotment is irregular, the applicant can avoid the allotment and can claim refund of the money. If the allottees of the company suffers loss, because of irregular allotment, the party concerned should be compensated by the person responsible for such irregular allotment. Further, he is also liable to be finedupto Rs. 5000/-.

If the allotment cannot take place within 120 days of the date of issue of the Prospectus, the applicants money must be refunded within the next 10 days, failing which the directors become jointly and severally liable for the refund of the money with interest at 6% from the expiry of the 130th day.

The Secretary should file a return of allotment with the Registrar within 30 days of the date of allotment with complete particulars regarding the number, nominal amount of shares alloted, the names and addresses of the allotees, etc.

7.3.8 Minimum Subscription

A company cannot allot shares unless the minimum subscription is received within 120 days from the date of issue of the Prospectus. Minimum subscription is the minimum amount which, in the opinion of the Directors, is necessary to provide for the following :

1. Purchase price for any property already purchased or agreed to be purchased;
2. Preliminary expenses;
3. Underwriting commission, if payable;
4. Repayment of the money if borrwed for any of the purposes mentioned above;
5. Working capital or any other expenditure.

If the minimum subscription amount is not received within 120 days from the date of the issue of the Prospectus, whatever money is received from the applicants,must be returned within the next 10 days (within 130 days after the issue of the Prospectus). If it is notdone,interest has to be paid.

It may be mentioned here that the conditions of minimum subscription is meant to prevent companies from coming into existence with inadequate capital so that only companies which can raise enough capital to meet this minimum requirement are allowed to start their business.

7.4 COMMENCEMENT OF BUSINESS

A Private company can commence business immediately after getting the certificate of incorporation from the Registrar. But a public company cannot commence business without getting another certificate called 'certificate to commence business' from the Registrar. For obtaining this certificate, certain conditions are to be fulfilled. They are :

7.4.1. that the prospectus or a statement in lieu of prospectus has been filed with the Registrar of Companies (a statement in lieu of the Prospectus has to be filed by those companies which do not issue Prospectus to the public for the issue of their shares);

7.4.2. that the number of shares alloted is not less than the minimum subscription mentioned in the prospectus;

7.4.3. that the Directors of the company have paid for their qualification shares in the same proportion as the members from the public have been required to pay on application and allotment.

7.4.4. that the declaration by a Director or the Secretary of the company to the effect that all the conditions regarding the commencement of business have been complied with.

If the Registrar is satisfied that all these conditions have been fulfilled, he issues a certificate to commence business.

The company get this certificate within one year of its incorporation. If it fails to get this certificate within this period, the court may order it to be wound up. It may be stated here that all contracts entered into from the date of incorporation till the date of the commencement of business are provisional and would become binding on the company only after it is issued the certificate to commence business.

7.5 SUMMING UP

After the selecton of the form of organisation comes the formation of the company. In this process ,there are three stages in the bringing up of the company. To make it do the business in the present the three processes in this business existence are :

1. Incroporation of a company
2. Prospectus-Issue and subscription
3. Commencement of business.

After the completion of the promotion in industry the next step is incrporaton of company. For the purpose of incorporation of company various documents have to be filed with the registrar of companies. With this the incorporatin of the companies is over. Once this job is completed the company will come into existence. After this, the company has to issue the prospectus to get finance from various sources. In this prospectus,the company has to give more details regarding the subscription of shares. The third aspect in this unit is the commencement of business. Though the company is incorporated and the prospectus is being issued, the company has to necessarily get the certificate of commencement of business. Unless this is done, the comapny cannot start its business. Normally it will take one year from the date of incorporation, to get the certificate of commencement of business.

7.6 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Name Clause
   ii) Situation clause
   iii) Object clause
   iv) Liability clause
   v) Capital Clause
   vi) Association or Subscription clause

2. If the company manages to get capital without public subscription, there is no need for it to issue a prospectus and instead, it can prepare a statement in lieu of a Prospectus containing almost similar information and file it with the Registrar.

7.7 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. What do you understand by Memorandum of Associaton? What are its contents and importance?
2. What is a Prospectus of a Joint Stock Company? What are its contents?

B. SHORT QUESTIONS

3. **What is meant by promotion of a company?**
4. **What is meant by Articles of Association?**
5. **What is the minimum subscripion?**
6. **What is a Prospectus?**
7. **What is a Certificate of Incorporation?**
8. **What is a Certificate of commencement business?**
9. **What is Statement in lieu of prospectus?**

7.8. RECOMMENDED BOOKS

Krishnaseami OR : 'Essentials of Commerce' : Eagle Publication Division, Madras 1981.

Pattanshetti CC and Reddy PN : 'Company Secretarial Practice' Mc. Gra Hill Publishing Co Ltd. New Delhi 1981.

Reddy PN and Gulshan SS : 'Principles of Business Organisation and Management'., S. Chand and Co.Ltd.,New Delhi 1981.

Bhushan Y.K. : Fundamentals of Business Organisation and Management Sultan Chand & Sons, New Delhi-110 002.

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Pattanshetti CC and Reddy PN	:	'Company Secretarial Practice' New Delhi : Mc. Gra Hill Publishing Co. Ltd. 1981.
Reddy PN and Gulshan SS	:	'Principles of Business Organisation and Management'. Chand and Co.Ltd.,New Delhi 1981.
Bhushan Y.K.	:	Fundamentals of Business Organisation and Management, Sultan Chand & Sons, New Delhi-110 002.

7.9. GLOSSARY

Certificate of Incorporation:	Issued by the Registrar of Companies as proof of the birth of a comapny legally.
Certificate of Commencement of Business:	Issued by the Registrar of Companies after the prescribed conditions are satisfied. This Certificate must be obtained by a Public Company for commencing its business.
Memorandum of Association:	A document which sets out the constitution of the company defining its relations with the outside world and the scope of its activities.

UNIT-8 : COMPANY MANAGEMENT

Contents

8.0 AIMS AND OBJECTIVES

This unit intorduces you to the different organs of Comapny management and the part played by those organs in the management of the company.

At the end of this unit, the student will be able to :

- tell the meaning of share holders
- understand the purview of Board of directors;
- know the functioning of managing director.

8.1. INTRODUCTION

The previous unit was an account of company incorporation and commencement of business. This unit is an exclusive description of comapny mangement where we study the different organs of company management i.e, share holders, Board of directors, and the Managing director.

8.2 ORGANS OF COMPANY MANAGEMENT

A company consists of a large number of share-holders staying in different places. As such, they cannot be expected to paly an active role in the management of day-to-day business of the company. It is impossible for the shareholders of a company to manage the company's affairs personally. Further, comapny management requires specialised skill and knowledge and we cannot expect this from shareholders who hail from different walks of life. Again, the number of shareholders in company is so large that it is impossible for the shareholders personally to carry on the business. In view of these factors, it becomes necessary for them to elect a few representatives who can act for them. Thus the shareholders act through a body of persons whom they elect as Directors at the annual General Body meeting. These Directors, consitituting the Board of Directors, take up the responsibility of carrying on the day-to-day management of the company. The powers and duties of these Directors are governed by the Memorandum and Articles of the company and the provisions of the Companies Act.

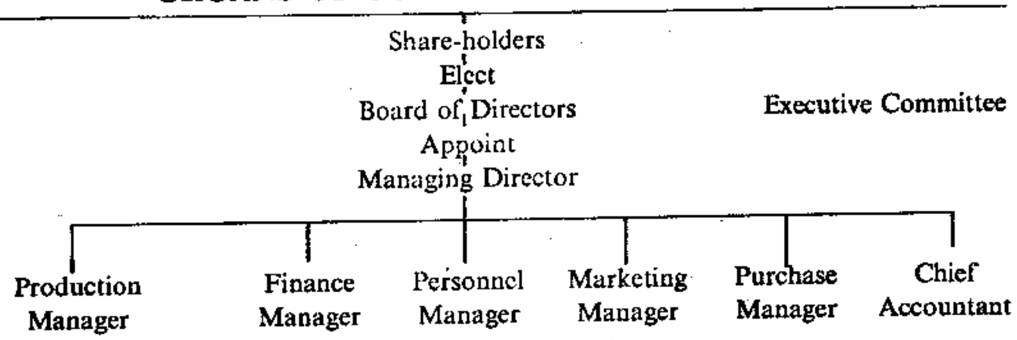
Thus it is clear that the shareholders' role in the management is rather nominal and that the effective powers of management are exercised by the Directors who are elected by the shareholders in the shareholders meetings.

The directors who are the elected representatives of shareholders are supposed to manage the company in accordance with the policy approved by the shareholders at their annual meetings.

The Board of Directors is thus the top administrative organ of the company.

The Directors are not whole time officials of the company and might be acting as Directors for a number of companies. However, the Indian Companies Act, 1956 stipulates that no person can be a Director in more than 20 Companies. Hence, they take mainly policy decisions at their meetings and leave them to the Managing Director and his team of excutives for implimentations. The Managing Director is one, who is a Director of the company working on a wholetime basis. The Managing Director functions as the Chief-Executive of the company and impliments the decisions of the Board of Directors through various Departmental heads like Production Manager, Purchase Manager, Marketing Manager, Personnel Manager, etc. Thus, the control of management of companies rests with the shareholders, Board of Directors and a whole time Managing Director. The organs of company management are shown in the chart given below :

CHART : 4 ORGANS OF COMPANY MANAGEMENT



UNIT-8 Check your progress -1

Name the organs of Company Management?

8.3 SHAREHOLDERS

We have already observed that the shareholders are the owners of the company but do not directly manage the affairs of the company. In view of this, there is a diverce between ownership and management in the company form of organisation. However, the Companies Act 1956 has given them certain rights in respect of their relationship with their company. These rights are classified into two broad categories viz., (a) Individual rights and (b) Group rights.

8.3.1 Individual rights :

They consist of rights which a share holder exercises in his capacity as an individual share holder without reference to other share holders.

The individual rights of shareholders are as follows :

a) to receive notices of General Body Meetings of the company and to vote at such meetings either in person or by proxy;
b) to receive dividend from the company when declared;
c) to transfer his shares subject to the restriction imposed by the Articles of the Company;
d) to inspect the records of the company as granted by the Companies Act and the Articles of the Company;

e) to apply to the court to have any variation of his rights set aside by the court;
f) to share in the assets of the company on dissolution.

8.3.2 Group Rights :

They consist of rights which the shareholders exercise as a group at the General Body Meetings of the Company.

The Group rights of Shareholders relating to their company's management are as follows

a) At every annual General Body Meeting of the company, the shareholders are entitled to determine the broad policies of the Company. They may approve or disapporve of the work done by their elected representatives and the policies followed by them.
b) They can also discuss at the annual General Body Meeting the Direcotrs' report, Profit and Loss account and Balance Sheet.
c) They also appoint auditors to audit the company's accounts.
d) They elect Directors.
e) They declare dividend at the rate recommended by the Board of Directors.
f) The shareholders can ask the Board to convene an extraordinary General Body meeting for the purpose of considering urgent matters. If the Board fails to convene the meeting, the requisitionists themselves can convene the meeting in accordance with the provisions of the Companies Act.

Even though the powers of management of the affairs of a company are entrusted to the Board of Directors, the Companies Act specifically provides for the exercise of certain powers by the Board only with the consent of the shareholders secured at a meeting.

8.4 BOARD OF DIRECTORS

The main functions of the Directors are to frame the policies for the company and to manage it.

8.4.1 Number of Directors

The Companies Act provides that every public company must have at least three Directors. In the case of a private company the minimum number is two. Subject to this requirement of the minimum of Directors, the Articles of a Company may fix the minimum and maximum number of Directors for its Board.

8.4.2. Appointment and retirement of Directors

The appointment of Directors is made as follows :

The subscribers to the Memorandum will be treated as the first Directors. These Directors will hold office till the first Directors are elected at the annual General Body meeting of the company.

Subsequently, the required number of Directors are elected by the shareholders at the annual General Body meeting. The Act provides that in public companies at least two-thirds of the total number of Directors must retire by rotation and at every annual General Body meeting, one third of them must retire. The retiring Directors, however, are eligible for re-election by the shareholders at the General body meeting.

Subject to the Articles, the Directors can fill in any casual vacancy in the Board and the person appointed in such vacancy continues in office only upto the next annual General Body meeting.

Sometimes on the basis of representation of shareholders, the Government exercises its right to appoint Directors of any company to prevent oppression or mismanagement.

Financial Corporations, debenture holders and banking companies which have lent money to the Company nominate Directors on the Board of the Company with a view to ensuring that the funds advanced by them are used by the company, for the purpose for which they are borrowed.

8.4.3. Share Qualification

The Articles of the company usually provide for a minimum share qualification for the Directors. The Companies Act provides that the nominal value of the qulaification shares should not exceed Rs. 5,000/-. At the time of appointment as Directors, if one does not possess qualification shares, he should purchase them within two months after his appointment.

8.4.4 Disqualification of Directors

Persons who are disqualified from being appointed Directors of a company are as follows:

a) undischarged insolvents;
b) persons of unsound mind;
c) persons who have applied to be adjudicated as involving;
d) persons who have been convicted of an offence involving moral turpitude and sentenced to imprisonment for not less than six months and a period of five years has not elapsed from the date of the expiry of the sentence.
e) persons in respect of whom calls are in arrears; and
f) persons who have been disqualified by an order of a court.

8.4.5 Powers and rights

The Companies Act confers certain powers and rights on the Board of Directors. The company may however, impose restrictions on the powers of the Board through a resolution passed at a General Body meeting. The powers of the Board can be broadly divided into two classes, namely i) powers that can be exercised by the Board meetings only and ii) powers that can be exercised only with the consent of the company obtained at a General Body meeting.

8.4.6. Powers that can be exercised at Board meetings

A) power to make calls on shares;
B) power to issue debentures;
C) power to borrow otherwise on debentures;
D) power to invest funds of the company;
E) power to make loans;
F) power to appoint a Secretary;
G) power to fill up a casual vacancy in the office of Directors subject to the regulations in the Articles;
H) power to fill up a casual vacancy in the office of auditor;
I) power to entre into contracts on behalf of the company with other parties;
J) power to make a contribution to the National Defence Fund without any limit;
K) power to forfeit shares.

8.4.7 Powers that can be exercised only with the consent of the sharesholders obtained at the General Body meeting;

A) To sell or dispose of a substantial part or whole of the undertaking of the company;
B) To remit or give time for the payment of a debt due from a Director;
C) To invest the sale proceeds from the sale of any property or undertaking of the company;
D) To borrow more than the total amount of paid-up capital and the free reserves of the company;
E) To donate to charities in excess of Rs. 50,000/- or 5% of the net profit in the course of any financial year;
F) To appoint sole selling agents for any area for a term exceeding five years at a time;
G) To appoint a Director or any relative or partner or firm of the Directors to any office or place of office except that of the Managing Director.

8.4.8 Sub-Committees of the Board

In a large company,the Board may constitute separate committees consisting of Directors to look after different functions of the Company (e.g., Works Committee, Share transfer Committee, Finance Committee, etc).

8.4.9 Duties of Directors

Some of the important duties of the Directors of a company are as follows :

to determine the minimum subscription amount;
to see that money received from the applicants for shares is deposited in a scheduled bank until it is refunded to the applicants under Section-69 or until the Certificate to commence business as obtained by the Company;
to prepare and file a copy of the statutroy report with the Registrar;
to send a copy of the statutory report to every member of the company at least 21 days before the date of the statutory meeting;
to call an extraordinary General Body meeting in the case of requisition by the specified

number of members;
to approve the Balance Sheet and Profit and Loss Account before they are sent to the auditors for their report;
to exercise only such powers as are given by the Company through the Memorandum and Articles of Associations;
to manage the affairs of the company as efficiently as possible;
to prepare the annual report of the company and take it alongwith the Profit and Loss account and Balance Sheet before the annual General Body meeting of the company;
to pay dividends only out of the divisible profits of the company;
to attend Board meetings regularly and not to fail to attend General Body meeting when they are reasonably able to do so;
to purchase the qualification shares within the specified time;
to disclose to the company their interest, if any, in any contract entered into by the company;
to see that the Board meetings are held at least once in every three months i.e. four times in a calendar year.

8.4.10. Liabilities of Directors

The liablilites of Direcotrs are limited like those of a member of a company. But if the Memorandum itself states that the Director's liability is unlimited, then in the event of liquidation, their personal properities will be attached to clear the company's liabilities.

If the Directors do anything ultravires of the powers of the company or the provisions of the Memorandum of Association, they are personally liable for such actions and the company cannot ratify them. But if the Directors do something ultravires of thier own powers, they are not presonally liable for such actions if they are ratified by the shareholders of the company.

The directors should not delcare dividned out of capital. In case they delcare dividend out of capital, they are personally liable. They are responsible for breach of trust and mistakes committed by them.

In case they misappropriate the funds of the company for their personal use, they are liable to criminal action. They are also liable for giving false information in the Prospectus of the company. In addition, they are also subject to criminal liability for fraud, delinquency, mismanagement and breach of trust.

8.5 MANAGING DIRECOTR

The Direcotrs, generally appoint one among themselves as Managing Director for the purpose of looking after the day-to-day administration of the company. The Board is given power to appoint the Managing Director either by its Articles or by the company at the General Body meeting.

8.5.1 Definition

The Companies Act 1956 defines 'Managing Director' as 'a Director who, by virute of an agreement with the company or of a resolution passed by the company meeting or by its Board of Directors or by virtue of its Memorandum or Articles of Association is entrusted with the substantial power of the management which would not otherwise be exercised by him and includes a Director occupying the position of a Managing Director, by whaterver name called'. The Managing Director must be an individual and he must be one of the Directors of the Board. Furthur, he has to exercise his powers subject to superintendence, control and direction of the Board of Directors which has appointed him.

8.5.2 Disqualifications for appointment as Managing Director

According to the Companies Act, the following persons are disqualified from being appointed Managing Directors:

a) an undischarged insolvent;
b) a person who has been adjusted insolvent or has suspended payment to or made a composition with his creditors;
c) a person who has been convicted by a court for an offence involving moral

turpitude.

For the appointment and reappointment of the Managing Director, the sanction of the Central Government is required. A person cannot be appointed as Managing Director for more than five years at a time.

Check your progress -2

What are the disqualifications for appoinment as Managing Director?

8.5.3 Functions of Managing Director

The Managing Director has a dual function, since he is a Director and also chief executive of the company. Generally, his chief functions consist of the following :

To take steps to impliment the policies of the Boards;
To formulate basic organisation structure;
To ensure effective co-ordination among all the departments of the Company;
To define the functions and responsibilities of the various members of the organisation;
To administer company production and sales activities;
The planning of Company's growth and extension of business;
To select staff and to arrange for their proper training;
To administer company finances and financial controls;
To maintain contact with government Departments, trade associations and other bodies in connection with the formulation and execution of policies and plans of the company;
to act as a useful link between the Board on the one side and the rest of the organisation on the other.

8.6 SUMMING UP

In this unit,the different organs of Company management and the role played by these organs are discussed. The different organs of company management are share holders, board of directors and other functional heads in the company. The shareholders are very important organ in the company. They are the owners of the company. The rights and duties of the share holders are discussed in detail. Next is the board of directors, these directors are elected from among the share holders. The appointment of directors, duties, powers and responsibilities of the directors are also given.

The managing director is also an important functionary in the company mangement. The managing director is elected or appointed from among the board directors. The appointment of managing director and his functions are discussed in this unit.

Finally the disqualifications are also given in detail. So company management will be successful with all the organs referred to in this unit.

8.7 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Share holders
   ii) Board of Directors
   iii) Managing Director
   iv) Functional Managers
2. a) An undischarged insolvent.
   b) A person who has been adjudged insolvent or has suspended payment to or made a composition with his creditors;

c) A person who has been convicted by a court for an offence involving more turpitude.

8.8 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. Explain the powers and rights of the Board of Directors.
2. Explain the various methods by which the Directors are appointed.
3. Define Managing Director and explain his functions.
4. 'The Managing Director is a link between the Board on the one side and the rest of the organisation on the other', explain.

B. SHORT QUESTIONS

5. What are the organs of company management?
6. State the various ways by which directors are appointed?
7. What is qualification share?
8. List out the duties of directors.

8.9 RECOMMENDED BOOKS

Krishnaswami OR	:	'Essentials of Commerce', Eagle Publication Division Madras 1981.
Pattanshetti CC and Reddy PN	:	'Company Secretarial Pratice' Mc. Gra Hill Publishing Co. Ltd., New Delhi 1981.
Reddy PN and Gulshan SS	:	'Principles of Business Organisation and Management' S. Chand & Co. Ltd., New Delhi 1981.
Bhushan Y.K.	:	Fundamentals of Business Organisation and Management- Sultan Chand & Sons New Delhi-110 002

8.10 GLOSSARY

Director	:	Any person who performs the functions of a Director, ordinarily elected by the shareholders at the General Body Meeting.
Managing Director	:	A Director who is entrusted with substantial powers of management which would not otherwise be exercised by him.

UNIT-9 : COMPANY MEETINGS

Contents

9.0 AIMS AND OBJECTIVES

This unit brings about the company meetings and how they are conducted. It also tells us the procedure of conducting the meetings of different nature. After going throug this unit; you will be able to:

- Explain different types of company meetings,
- describe the procedure and conduct of meetings
- explain different types of company resolutions

INTRODUCTION

In the previous unit, the different organs of company management are studied, and this unit explains the different types of company meetings. 1. Statuory meeting; 2. Annual general Body meeting; 3. Extraordinary General Body meeting. It also explains nature and kinds of company resolutions and the procedure to adopt for the same.

In the management of a company, meetings play a vital role as it is only at the meetings many decisions concerning the company's management are taken.

Broadly speeking, companies have the following kinds of meetings :

1. meetings of the Board of Directors and its committees;
2. meetings of members;
3. meetings of debenture holders and creditors.

The rules and regulations for conducting these meetings and the nature of work transacted at such meetings are discussed ub detail.

9.2 MEETINGS OF BOARD OF DIRECTORS

9.2.1 Introduction

At these meetings, only the Directors can take part. Meetings of the Directors consist of Board meetings and Committee meetings. These meetings are conducted according to the provisions of the Companies Act and also according to the provisions of the Articles of

Association of the Company concerned.

A meeting of the Board of Directors should be held at least once in every three calender months. Notice of meetings of the Board of Directors must be given in writing to every Director. Usually, the agenda of the meeting is sent alongwith the notice of the meeting. The quorum for Board meeting should be at least two directors or 1/3rd of a total strength of the Board whichever is more, subject to a minimum of two Directors.

Business generally done at the Board meeting relates to the allotment of shares, calls, forfeitures, transfers, recommendation of dividend, declaration of bonus, issue of debentures, etc.

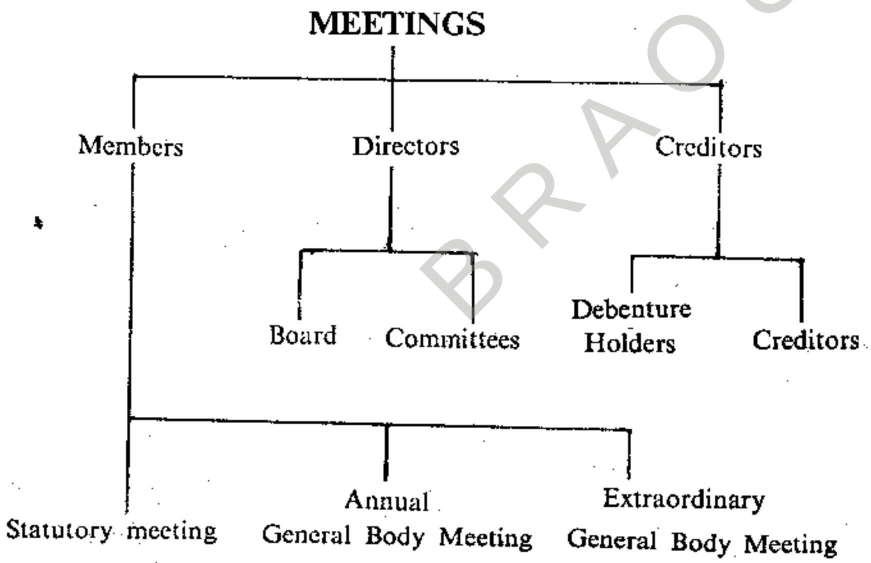
9.2.2 Minutes of Board meetings

Minutes are the written record of the business transacted at a meeting. After the meeting of the Board, the Secretary prepares the minutes of the meeting. The minutes will be read by the Secretary at the next meeting and, if found in order, they will be signed by the chairman.

9.2.3 Meetings of the Committees of Directors

The Board of Directors may constitute certain committees consisting of only Directors and delegate some of its powers to them. These committees may be constituted for a specific purpose or may be constituted as standing committees on a permanent basis. The delegation of powers to such committees should be authorised by the Company's Articles and should be subject to the provision of the Companies Act. These meetings are also held in the same way as those of the Board of Directors. Generally, in large companies routine matters like finance, transfer of shares, allotment of shares are handled by the sub-committees of the Board of Directors.

CHART 5 : CLASSIFICATION OF MEETINGS



9.3 MEETINGS OF MEMBERS

Meetings of shareholders of two categories ; viz., 1) Statutory meeting, and 2) General Body meeting. Again the general body meeting may be of two types : a) Annual General body meeting, and b) Extraordinary General Body meeting.

9.3.1 Statutory meeting

It is the first meeting of the shareholders of a company and it is held only once in the whole life of the Company. This meeting must be held by a public company within a period of not less than one month and not more than six months after the date on which it is entitled to commence business. If this meeting is not held, every Director or any other officer who is in default would be punishable with a fine of Rs. 5,000/-. Further, the court can order the winding up of the Company.

The purpose of this meeting is to inform the shareholders about matters relating to incorporation, allottment of shares, details of contracts concluded by the company etc. The Secretary prepares a report known as 'statutory report' which is sent to every member of the company along with the notice of meeting.

The statutory report should contain the following particulars :

A) total number of shares allotted, number and types of shares and amount paid up on them ;

B) an abstract of receipts and payments is under distinctive Heads;

C) an account of the total amount of cash received by the company in respect of all the shares allotted;

D) an estimate of preliminary expenses showing separately any commission paid on the issue or sale of shares and debentures

E) names and addresses of directors and auditors and of Managing Director and Secretary if any;

F) particulars of underwriting contracts if any;

G) arrears, if any, due on calls from Directors;

H) if any contract is to be modified, the particulars of such a contract and the proposed modifications.

The statutory report must be signed by atleast two Directors and by the auditors of the company. A copy of this report must be filed with the Registrar immediately after the reports are sent to the members. Further, a list of members showing the number of shares held by each one of them has to be produced at the meeting and this list must be accessible to the members while the statutory meeting continues. At the meeting, members can raise any matter relating to the formation of company or arising out of the statutory report.

9.3.2 Annual General Body Meeting

It is a meeting of the shareholders which is held every year. As per the provisions of the Companies Act,the first annual General Body Meeting must be held within 18 months of the date of incorporation and in the following years, it must be held within 15 months of the preceeding annual General Body Meeting. Twenty one days' notice must be given to all the members and certified copies of Balance Sheet and Profit and Loss Account, Auditor's report and Director's report must accompany the notice. The date of the meeting is decided by the secretary in consultation with the Directors. The usual business transacted at this meeting is as follows :

A) adoption of annual accounts and the audit report;

B) adopion of Director's Report;

C) declaration of dividend;

D) election of Directors in the place of those who retire;

E) appointment of auditors and fixing their remunerations.

Explanatory Statement : If any business other than those stated above is to be considered at an annual meeting, that business is known as a special business. For transacting any special business, it is necessary to send an explanatory statement to the members along with the notice convening the meeting of the shareholders.

Directors Report : Director's report which is sent to the members along with the notice of annual Genral Body meeting must be drafted by the Secretary and approved by the Board of Directors. The main purpose of this report is to inform the members about the work done by the company during the year covered by the report. Sometimes, other details such as future prospects, bonus to staff or share-holders, transfer of profit to reserve fund etc. are also included in the report of the Directors.

Chariman's speech : It is necessary for the Chairman to deliver a speech at the annual General Body Meeting. Generally, the Secretary drafts the Chairman's speech covering every aspect of the company's working.

Minutes of general body meeting : While the meeting is in progress, the Secretary makes notes on the basis of which he would prepare the minutes of the meeting.

9.3.3 Extraordinary General Body meeting

It is a General Body meeting held between two annual General Body meetings. It is called to discuss some special or urgent business to be transacted before the next annual General Body meeting. It may be called to discuss the alteration of any clause in the Memorandum or changes in the Articles or to discuss the scheme of reduction of capital, etc.

This meeting is called by the Directors, but if they fail to arrange the meeting, the shareholders holding not less than 1/10th of the paid up capital can send a requisition to the Directors for arranging the meeting. The Directors should convence the meeting within three months of the date of their requisition. Any expenditure incurred by the requisitionists on the arranging of the meeting will be reimbursed by the company. A 21 days notice has to be given to the members indicating the nature of subject to be discussed at the meeting. The resolution passed at such a meeting should be field with the Registrar within 15 days of the meeting.

Check your progress-1

What is meant by extraordinary general body meeting.

9.4 Meeting of Creditors : Some persons provide money to the companies in the form of a loan. The Companies Act,1956 provides for the meetings of the creditors when matters relating to the interests of creditors arise. Such meetings are held when proposals relating to creditors relationships with the company are to be discussed and their consent is required. The creditors are not concerned with the regular working or policies of the company, therefore, they are not generally called to attend the general meetings of the company. They are invited to their meetings and these meetings are covered and conducted as per rules and regulations, which are applicable to other types of meetings.

9.5 PROCEDURE AND CONDUCT OF COMPANY MEETINGS

Companies Act has made a number of provisions relating to matters connected with meetings, votes etc. The procedure followed at the General Body meetings of the company may be studied under the following heads:

9.5.1 Notice of meeting

For holding a meeting, 21 days' notice should be given to every member of the company. For passing a special resolution if any, 28 days's notice should be given. If proper notice is not given, the meeting should become invalid.

9.5.2 Quorum

Quorum means the minimum number of members of any body or society whose presence is necessary for the validity of the proceedings at any meeting. The Company's Act provides that five members personally present in the case of a public company and two members personally present in the case of a private company shall be the quorum for a company's meeting. However, the company by its Articles can provide for a larger number than the number fixed by the Companies Act for forming a quorum.

If there is no quorum for a meeting within half an hour of its scheduled time, the meeting shall be adjourned to the same day in the next week at the same time and place. If there is no quorum even at the adjourned meeting, the members present at such a meeting shall be the quorum and they can proceed to conduct the business of the meeting.

Check your progesss—2

What is meant by quorum?

9.5.3 Chairman

The Chairman is the person responsible for the proper conduct of the proceedings of the meeting. In most of the companies, the Chairman of the Board of Directors presides over the General Body meetings. If the Chairman of the company is not present within 15 minutes of the time fixed for the commencement of the meeting, the Direcors shall elect one of their members to be Chairman of the meeting. If no Director is willing to act as a chairman, the members present shall elect one of themselves to be the chairman of the meeting.

Qualifications necessary for the making of a sucessful Chairman : The Companies Act does not laydown any qualification for the Chairman, but ordinarily he is expected to possess special knowledge of the business. He should also be reasonable, good tempered, patient, tactful and should be in a position to command respect of those present at the meeting. As Albert Crew observes in his book entitled 'Procedure at Meetings', "the ideal chairman should be a man of infinite tact and patience, possess a judicial mind, be able to command the respect of the meeting, be absolutely impartial in his rulings never allowing the latter to be questioned-and always ready and resourceful when difficulties arise. He should be firm yet courteous, able to govern men, not allowed himself to be carried away by party or other feelings, able to endure bores cheerfully and circumvent mere obstructionists skillfully"

Duties and powers of the Chairman : The duties of the Chairman are as follows :

a) he must see that the meeting is properly convened through the requisite notice and that the requisite quorum is present;
b) he must also see that the minutes of the last meeting are confirmed by the meeting.
c) he has to see that strict order is observed throughout the meeting;
d) he must ensure that the various items of business are taken up in the order in which they appear in the agenda;
e) he must see that every member present has a fair opportunity to be heard on the issues discussed at the meeting;
f) he should decide the order of speakers and gide the deliberations with such fact and patience that the meeting transacts the business peacefully;
g) he must prevent irrelevant discussions by any member;
h) he should also ascertain the sence of the meeting and announce the results if voting is taken;
i) he should not dissolve the House prematurely and cannot bring the meeting to a close by vacating the chair.

It should be noted that the Chairman enjoys supreme authority in the conduct of a business at a meeting. His rulings on points of order and procedural questions are final and binding on every member. The Chairman has to enforce order at the meeting; and if any person behaves in a disorderly manner, the Chairman has the right to ask him to behave properly or else to withdraw. The Chariman also has the right to adjourn the meeting if he feels that it is impossible to maintain order.

9.5.4 Casting vote

If the Articles so provide, the Chairman can exercise the casting vote in addition to the original vote exercised by him as a member of the company if the cast for and against motion are equal. Thus, the Chairman has two votes, namely, i) his original vote as a member of the company and ii) the casting vote which he exercises in case there is a tie on any issue.

9.5.5 minutes

The first item to be taken up at the General Body meeting is the reading of mimutes of the last meeting by the Secretary for confirmation. The minutes of the meeting must be recorded in a proper Minutes Book and they should provide a fair and correct summary of the proceedings of the meeting.

9.5.6 Motions

After confirming the minutes of the last meeting, the items of business listed in the agenda are taken up. For taking up each item of business, a motion has to be tabled at the meeting. A motion which is a proposal moved by a member becomes a resolution only when it is passed at the meeting. A motion must be in writing and must be framed in an affirmative form.

9.5.7 Amendments

An amendement is a motion proposed with a view to making some alteration in the original motion, i.e., either omitting certain words from the original proposition or adding to or substituting them. In case, the motion of amendement is passsed at the meeting, the original motion as altered by the amendment is put to vote at the meeting.

9.5.8 Vote and Poll

A vote may be exercised either by a show of hands or by a poll. Voting by show of hands means every shareholder present will have one vote irrespective of the number of shares held by him. But in a Joint Stock Company it is privided that the voting powers of the shareholders are in proportion of the shares held and accordingly poll may be demanded by the members. The advantages of poll are:

a) each member's votes are counted according to the number of shares held by him;
b) the proxies are also counted.

9.5.9 Proxy

A Shareholder who is unable to attend a meeting can appoint a proxy to represent him at the meeting. For this,he has to fill in a form called Form of Proxy and hand it over to the person who has to represent him. A proxy can vote if poll is taken.

In accordance with the extent of power vested in a proxy is vote, there are two kinds of proxies : A special proxy is one who is autorised to vote upon a particular resolution. A general proxy is one, who is empowered to vote upon all proposals presented at a meeting.

Check your progress-3

Who is proxy?

9.5.10 Closure

If a debate on the question before the meeting has been dragging for a long time, any member may move for a closure by demanding that 'the question be now put to vote'. If seconded, the Chairman should put it to vote and if carried, no further discussion on that question should be allowed. If, however, the motion for closure is lost, the discussion may be resumed.

9.5.11 The previous question

When a main motion is under discussion, if any member feels that it is not desirable in the interest of the company to discuss it, he may move what is called 'previous question'. The wording of this proposition is 'that this question be not now put'. It means, that the meeting must consider the question previous to the qustion before the House. If the motion regarding 'previous question' is adopted, it will mean that the meeting has decided in favour of postponing the discussion on the original action.

9.5.12 Next business

If any member feels that it is not desirable to take a decision on a particular motion, he can move 'that the meeting proceed to next business'. If this motion is carried, the original motion is dropped.

9.5.13 Postponement

If any member wants the discussion on a particular motion to be postponsed, he can move 'that further consideration of the mition be postponed'. If this motion is carried, the discussion on the particular motion is postponed.

9.5.14 Adjournmet

The form of resolution used for adjournment of a meeting is 'that this meeting be now adjourned'. The adjourment can be either for a particular period or indefinitely.

9.6 RESOLUTIONS

If any motion is put to vote and supported by the requisite majority, the motion becomes a resolution. Resolutions are of three types. They are :

a) ordinary resolution
b) special resolution
c) a resolution requiring special notice.

9.6.1 Ordinary resolution

An ordinary resolution is one passed by a simple majority of members entitled to vote either in person or by proxy, whether by a show of hands or by a poll at a General Body meeting of the shareholders of which 21 days' notice has been given to members. The following are some of the matters which can be decided by aan ordinary resolution :

1. election of Directors
2. appointment of auditor
3. approval of accounts
4. declaration of dividend
5. alteration of capital
6. creation of reseve fund

9.6.2 Special resolution

A special resolution is one which is passed by at least 'the majority of the members voting on it at a General Body meeting. The essentials of a special resolution are as follows :

21 days' notice must have been given for the meeting at which the special resolution is to be passed.
Notice of the meeting should specify that the resolution is intended to be proposed as a special resolution.
The number of votes cast in favour of the resolution should be three times the number of votes against it.

The Companises Act has specified the matters which require the adopiton of special resolutions. They are:

alteration of the name and objects of the company;
removal of the registered office from one state to another;
alteration of the Articles;
reducion of captial;
creation of reserve liability;
payment of interest out of capital;
the determining of the remuneration payable to Directors;
the making of the liability of its Directors and Managing Director unlimited;
the winding up of the company by the court;
the voluntary winding up of the company;
the sanctioning of the appointment of a relative of a Director to any office of profit under the company;
L) the petitioning of the Central Government to investigate into the affairs of the company.

9.6.3 Resolutions requiring special notice

Some matters specified in the Act cannot be moved for discussion at a General Body meeting unless a special notice is given to the company. A notice containing the intention to move the resolution has to be given in such cases at least 14 days before the meeting is scheduled. The company in turn must give notice to the resolution atleast 7 days before the meeting.

Matters requiring special notice are :

A) removel of a Director before the expiry of his term;
B) appointment of a Director in the place of the one removed;
C) appointment of certain persons as Directors who are otherwise ineligible;
D) appointment of any person other than a retiring auditor as auditor;
E) decision suggesting that a retiring Director shall not be re-appointed.

After a special resolution had been duly passed, the secretary within 30 days of the date of the passing of the resolution must file a copy of it with the Registrar.

Check your progress-2

Name the kinds of resolutions in the company meetings.

9.7 SUMMING UP

Broadly speaking there are three types of meetings. i) Meetings of board of directors ii) Meetings of members. iii) Meetings of the Creditors. Again the meetings of members are divided in to three categories i) Statutory meeting; ii) Annual general body meeting and iii) Extraordinary general body meeting.

The meetings of Board of directors are meant for discussions regarding the allottment of shares, share calls, forfeiture of shares, transfers, recommendations of dividend, declaration of bonus, issue of debentures etc. These meetings are held at least once in every three calender months. The meetings of members i.e., statutory meeting is held once in the whole life of the company. In this meeting,the share holders are informed about the incorporation, allotment of sharesand the details of the contracts entered by the company. The next is Annual general body meeting of share holders, which is held every year. This meeting is supposed to discuss about annual accounts, declaration of dividend, election of directors and appointment of auditors. The extraordinary general body meeting is convened between two annual general body meetings to discuss urgent matters regarding alteration of the memorandum or Articles or to reduce the capital.

After the meetings, the procedure laid down to conduct the meetings is discussed. Regarding the quorum , casting of vote, minutes, Amendments, proxy, adjurnment etc. Coming to the resolutions there are three types i) Ordinary resolution, ii) Special resolution ; iii) Resolution requiring special notice. The ordinary resolution is meant for election of directors, appointment of auditors, approval of accounts etc. The special resolution is passed by the majority. The resolutions are regarding alteration of name and objects of company, reduction of capital payment of interest out of capital etc. The resolutions regarding special notice are removal of directors before the expiry of the term and appointment of directors who are ineligible. Thus the meetings and resolutions are discussed in this unit.

9.8 CHECK YOUR PROGRESS : MODEL ALSWERS

1. It is a general body meeting held between two annual General Body meetings. It is called to discuss some special or urgent business to be transacted before the next annual general body meeting.
2. Quorum means the minimum number of members of any body or society whose presence is necessary for the validity of the proceedings at any meeting.
3. A shareholder who is unable to attend a meeting can appoint a proxy to represent him at the

meeting. For this,he has to fill in a form called form of proxy and hand it over to the person who has to represent him.

4. Ordinary resolution, Special resolution and A resolution requiring special notice.

9.8 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. Describe briefly the different classes of company meetings mentionning the nature of business conducted at each one of them.
2. What is a Special Resolution? For what purpose is a special resolution is required?
3. What is a Statutory Report? What are the contents of statutory report,

B. SHORT QUESTIONS

4. What is a Statutory meeting?
5. What is an Extraordinary General Body meeting?
6. State the meaning of the term 'Quorum'?
7. What is the casting Vote?
8. What are minutes?
9. What is 'Proxy'?
10. What is 'explanatory statement'?

9.9 RECOMMENDED BOOKS

Krishnaswami OR	:	'Essentials of Commerce' : Eagle Publicaion Division Madras 1981.
Pattanshetti CC and Reddy PN	:	'Company Secretarial Practice' : Mc. Gra Hill Publishing Co. Ltd., New Delhi 1981.
Reddy Pn and Gulshan SS	:	'Principles of Business Organisation and Management' S. Chand & Co. Ltd, New Delhi 1981.
Bhusan Y.K.	:	"Fundamentals of Business Organisation and Management" Sultan Chand & Sons, New Delhi 110 002

9.10 GLOSSARY

Annual General Body Meeting	:	The meeting of the shareholders held every year to consider the annual accounts, auditors' reports, dividends, election of directors, etc.
Extraordinary General Body Mee-ting	:	A meeting of the shareholders held between two annual general body meetings to discuss some special and urgent matters.
Minutes	:	The record of proceedings at a meeting.
Proxy	:	Any person appointed by a shareholder to represent him at a certain meeting or meetings.
Quorum	:	The minimum number of members of any body or society whose presence is necessary for the validity of the proceedings at any meeting.
Statutory meeting	:	This is the first meeting of share holders this will be held before six months and after one month from the date of obtaining the certificate of commencement of business.

UNIT-10 : PRINCIPLES OF COOPERATION

Contents

10.0 AIMS AND OBJECTIVES

This unit explains the concept of cooperation, the objectives of cooperation and the principles of cooperative societies. After the study of this unit, the student is able to:

- define cooperation
- tell the need for cooperation
- explain the objectives of cooperation
- describe the principles of cooperation

10.1 INTRODUCTION

The previous unit is concerned with the company meetings and the company resolutions, and how they are conducted. This unit explains about the cooperative societies and their nature.

Co-operation, one of the "economic miracles of the last century", is a form of economic organisation based on certain higher values. It is a voluntary and democratic association of human beings based on equality of control and opportunity, equity of distribution and mutuality for the promotion of their common interests as produces or consumers. It directly serves its members interests, by meeting their needs, but does not earn profit for itself as an independent economic unit, at their cost. Nor is it meant for earning profits from rendering services to others. It is organised or the benefit of its members. Therefore, co-operative business is different from other concerns which render service to others but are owned by and run for the personal profit of their owners.

Co-operation serves as a organisational instrument for economically weaker producers like farmers, artisans, workers, and consumers. It helps them to strengthen and protect themselves against exploitation by the stronger sections. When these economically weak person act individually, they are exploited by the stronger ones. For exmaple, farmers are exploited by money lenders and merchants; workers by employers and consumers by traders. Co-operation helps such people of the weaker sections to escape exploitation by enabling them to become their own financiers, merchants, employers or traders. It helps them "to gain the advantages of large scale opeation, while maintaining their independence". Co-operation thus enables them to fulfil their needs economically and honourably.

10.2 DEFINITION

10.2.1 Definition

Co-operation has been defined by many authors. Among the avilable definitions, that of

H.Calvertis the mostacceptable one.Calvert has defined cooperation as "a form of organisation where in persons voluntarily associate together as human beings on the basis of equality for the promotion of the economic interests of themselves".

The moral and social aspect of co-operation can be understood in the following definitions:

"Co-operation is something more than a system. It is a spirit which appeals to the heart and the mind. It is a religion applied to business. It is a gospel of self-sufficiency and service". (M.L.Darling).

"Co-operation is self-help as well as mutual help. It is a joint enterprise of those who are not financially strong and cannot stand on their own legs and therefore came together not with a view to get profit but to over come disability arising out of want of adequate financial resources and thus better their economic conditions". (Dr. K.N. Katju).

10.3 OBJECTIVES OF CO-OPEATION

The objectives of Co-operation can broadly be divided into the following :

i. To promote the economic interests of its members.
ii. To improve the conditions of the members both materially and morally.
iii. To satisfy the common economic needs of its members, such as the provision of cheap credit and the supply of pure and unadulterated goods.
iv. To encourage savings among its members.
v. To cultivate, in general, thrift self-help, self-reliance and co-operation among its members.
vi. To create a new social order through reduction of inequalities in the distribution of income and wealth and eliminating exploitation of the poor and helpless.

In order to achieve the above mentioned objective, co-operation follows peaceful but revolutionary methods.

10.4 PRINCIPLES OF CO-OPERATION

The Principles of Co-operation have undergone an evolutionary change. When the first successful Co-operative Society. "The Equitable Rochdale Pioneers Society" was started according to the circumstances then existing, the Rochdale Pioneers founded certain principl s. These principles have undergone some changes. The International Co-operative.

10.4.1 Voluntary and Open Membershop

The membership of a co-operative society is neither restricted nor limited, because the object of the association is the common good and those who join it must exhibit no selfish spirit. The only qualification to become a member of a Co-operative is the attainment of the age of majority. There cannot be any restriction to membership based on caste, creed, sex, religion or party politics.

There is, however, some kind of restriction based on two grounds. One is common economic need. The members joining a society should have a commom goal. This is mostly based on the occupation of the members. For instance, in a Co-operative Credit Society the agriculturist members need credit at low rates of interest; in a co-operative stores, the members need supply of goods at low prices and in a Weavers' Co-operative Society the weavers have the common economic need of getting continuous employment. Therefore in a particular Society, only those belonging to a particular profession are admitted. Thus in a Weavers' Co-operative Society only weavers are admitted. According to V.L. Mehta, "co-operation is one aspect of a vast movement promoting voluntary associations of indivuduals having common needs who combine towards the achievement of common economic ends". The second ground for restricting membership is related to the nature of the group. Persons who are considered to be exploiters will not be admitted in the Co-operative Society. Village money lenders are not to be admitted to a Co-operative Credit Society, private traders to a Co-operative Stores, master weavers to a Weavers' Society and so on. Though this restriction is not actually followed now a days in our country, it is based on the assumption that such people, if admitted, will exploit the Co-opeative Society also.

The movement is absolutely voluntary and there is no compulsion or force on any body to join a Society. After joining it, they are at liberty to leave the organisation, if they wish to do so. The Co-operative Society can develop, only when it has persons who can understand and follow this spirit of co-operation and mutual help. This requires a clear understanding and conviction on the part of the members. This is possible only in voluntary membership Compulsion of any kind would make the members disloyal and would prove to be dangerous for the Co-operative Society. Hence voluntaryism is an important principle of Co-operation.

However, in developing countries like India there is deviation from this pricniple. In such countries people are generally conservative and the percentage of literacy is low. Therefore people do not have a clear understanding of the utility of co-operation. Therefore if the promoters are to wait till everyone understands the spirit of Co-operation and is convinced about it, it can never come into existence. Furthur such countries have launched economic planning programmes which involve an element of compulsion to fulfill targets. Hence, in these countries compulsion is resorted to.

Besides this general deviation, there are specific instances of compulsion too. For example, when a Co-operative Farm is being orgainised in a village, if a member (whose holding is in the middle of those acquired for the purpose) is not willing to join the Co-operative Farm and to pool his land, there is no alternative but to compel him. In such cases, either the person has to become a member and pool his land or accept an alternative piece of land in lieu of his holdings.

10.4.2 Democratic Management

Co-operative Societies, are managed purely on democratic principles. The democratic management of the societies is based on the following aspects;

The general body consisting of all the members is the all powerful supreme body. This general body elects a smaller body to manage the affairs of the society. This smaller body is called Board of Directors, Managing Committee, or Panchayat. The responsibility of managing day today affairs of the society rests with another body, namely the Executive Committee.

In all the elections, the principles of 'one man one vote' is followed irrespective of the number of shares held by the member. The spirit,democratic management in Co-operative Societies can be understood when we compare it with that existing Joint Stock Companies. In companies,each share is given a vote and hence the largest shareshalder can dominate the affairs of the company.

In all the bodies in Co-operative Society, decisions are taken on the basis of majority though the interest of the minority is also kept in mind. In annual general meetings, proxy is not allowed either for attendance or for voting. This is one of the essential pricniples of democracy followed in co-opeation. This is not present in other type of organisation.

10.4.3 Limited Interest on Capital

In Co-operation, justice is done in the distribution of the surplus earnings of profits. The distribution of profit in a Co-operative Society is equitable. Equity demands that only a fair return should be paid to capital for its service, and that capital should not hold a dominant positions in the affairs of the Co-operative as in other organisations. Thus equitable distribution of profit implies a limited interest on capital. For instance in the Co-operative Societies in India, there is a ceiling on dividend on share capital at 9%.

10.4.4 Patronage Dividend

Profit is used for creating reserves, for general as well as specific purpose like co-operative development Fund, Common Good Fund and Education Fund.

Any furthur surplus is distributed among the members after giving a small share to labour as bonus. Generally the members of the Co-operative Society are its customers. Therefore it is the member-patrons who actually contribute to the profits of the Co-operative Society. As Co-operatives aim at promoting members' interest they are not expected to earn profits from them and to render service at cost. Therefore the profits earned out of the transactions with the member-partrons are returned to them after meeting the limited interest on capital and the reserve requirements. While returning the amount, the extent of individual contribution is also taken into consideration. This dividend is distributed according to the volume of transactions each member had with the soceity share. In the words of C.R. Fray "the members of the Co-operative Society share its rewards in proportion to the degree in which they make use of the association". Therefore this dividend is called Patronage dividend. This patronage dividend is "the essence of co-operation as the operation of the equity principle reduces the distance between the rich and the poor wtihout denying opprotunities for individual initiative and creative activity".

Check your Progress -1

What is patronage dividend?

10.4.5 Co-operatives among Co-operatives

A Co-operative association is not an association of selfish individuals. No one can try to gain his own objective at the cost of others. There prevails a co-operative instead of competitivepirit. The members are united in a Co-operative Society to undertake common action for common welfare", and for that reason Co-operative Soceities, in turn federate thmselves into Co-operative Unions and Federations for common action instead of competing with each other.

10.4.6 Co-operative Education

A Co-operative Society is a voluntary organisation and members cannot be kept together by compulsion. Educating the members in co-operative principles is the only alternative. The movement is meant only for the poor illiterate people who know very littel about the principles and practices of co-operation. Therefore a continuous system of eudcation should be evolved and the members should be kept informed of the decisions and activities of the soceity. Such a system should not confine itself to teaching principles of co-operation alone. It should have the broader aim of inculcating in the members, the good habits of thrift, saving, hard work, etc. Its object should also be to make them better consumers, honest workers, better social beings, trained electors, useful citizens and more disciplined and responsible human beings.

Besides the above principles enunciated by ICA, the following practices have also been conventionally accepted as principles of Co-operatives.

10.4.7 Self-help Through Mutual Help

Self-help through mutual help is the guiding principle of co-operation. The members are for the Society and Society is for helping them. This principle envisages that the members try to draw advantage out of the bigger pool resources created by the common efforts of all concerned. The individual member derives help from others by extending his help to others. "Each for all and all for each" is the motto of Co-operation. "Co-operation is the act of persons voluntarily united for utilizing reciprocally their own forces, resources of both under their mutual arrangement to their common profit or loss". (Herrick).

10.4.8 Service Motive

A Co-operative Society is meant not to earn profit but to enable its members improve their economic condition by helping them in their pursuits. Again, it is not only a movement for economic betterment. Co-operative action on the part of human beings for the satisfaction of their common needs based on democratic principles, leads to the development of higher values of life like, honesty and unselfishness. An unselfish spirit and honest dealing are very essential to practice "self-help through mutual help".

The service motive of Co-operatives, however, does not mean that they are against profit An efficiently managed Society must, of necessity, run in profit. The profit is meant to meet unforeseen losses, if any, at a later stage. They are also utilised to strenghen the funds of the Society, so that it may be able to render better and cheaper service to its members and make its footing strong. Any surplus left over again goes to members in the form of dividend or bonus. The main objective is to avoid the profit motive, and not profit for itself which would result from good management of the Co-operative.

10.4.9 Principle of Thrift

A Co-operative Society is in its essence a thrift institution, a body inculcating thrift in the members. Co-operation does not seek to do away with capital which is as much necessary in a Co-operative Society as in any other business concern. Thrift combined with Co-operation can ransform the economic status of a country and with Co-operation, thrift is given an added momentum. Hence the idea of thrift as the basis of self-help is kept in the forefront in organising and conducting Co-operative Societies.

10.4.10 Principle of Equality

Co-operation recognises human individuality. In Co-operative Societies,all the members are equal. There can be no discrimination on the basis of caste, creed, sex, religion, politics or wealth. This is reflected in the principle of 'one man one vote'. Besides this, co-operation aims at giving equal oportunity to all its membes to become leaders and share in the management.

Check your progress-2

What is a principle of equality ?

10.4.11 Neutrality in Religion and Politics

Co-operation is an international movement and its object is the economic and social uplift of human beings. It cannot deny its advantages to some persons simply because of their religious and political affiliation. Therefore the Co-operative movement should remain above politics and religion. It is on the basis of this principle that the movement has flourished as successfully in democratic countries-as it has in the Socialistic countries.

10.5 SUMMING UP

Co-operative movement has been living in India as a workable activity in the operation of many activities in the daily life of a man. In this, the origin of the cooperation is given. It is a form of economic organisation based on certain higher values. It is a voluntary and democratic association of human beings based on equality of common interest.

Cooperative societies are started by the poor and economically weak to promote their economic interests. So many institutions are established on the cooperative principles. Earlier there was no such organisation and this is the hour of need to develop these and extend to all walks of life. Compare to sole traders, partnership and joint stock companies, the cooperatives are with in purview of commonness and self help. The objectives of cooperation are to promote economic interest of members, to satisfy their needs, to cultivate saving attitude among members, self help and cooperation among members and finally to create a new social order.

Coming to the principles, the cooperation aims at democratic management, patronage dividend, service motive, self help through mutual help principle of equality etc. Nevertheless, it goes with out saying that these institutions are established for the poor and weak, to reduce the inequalities, to recognise the personality of a man, prepare men for public service and finally it is for socio-economic and moral movement.

10.6 CHECK YOUR PROGRESS : MODEL ANSWERS

1. The profits earned out of the transactionswith the members.Patrons are returned to them after meeting the limited interest on capital and the reserve requirements. The dividend in the form of profit is called patronage dividend.
2. It is a principle of 'one man one vote' and given equal opportunity to all its members to become leaders and share in management.

10.7 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. Explain how Co-operation is a Socio-economic and Moral Movement.?
2. How is the democratic management in co-operation different from that in Joint stock Companies?

B. SHORT QUESTIONS

3. Define Co-operation.
4. What is meant by equlity in cooperation ?
5. What is patronage dividend?
6. What is meant by Thrift ?
7. Mention any three features of Co-operative societies.

10.9 RECOMMENDED BOOKS

1. **Hajela T.N.** 'Principles, Problems and Practice of Cooperation', Shivalal Agarwala and Company, Agra 1982
2. **Krishnaswamy O.R.** 'Essentials of Commerce, Eagle Press Publications Division, Madras 1981.
3. **Krishnaswami. O.R.** 'Fundamentals of Cooperation, S. Chand and Company Ltd., New Delhi, 1978.
4. **Mathur B.S.** 'Cooperation in India, Sahitya Bhawan, Agra, 1982.
5. **Reddy P.N. and Gulshan, S.S.** 'Principles of Business Organisation and Management, Eurasia Publishing House (P) Ltd., New Delhi, 1981.

10.10 GLOSSARY

Allientation	: Transfer
Bill	: Bill of Exchange
Co-operative Society	: Society registered under the Cooperative societies Act of the respective State Governments.
Distribute Justice	: Justice and fairness in distributing the gains of cooperative effort.
Equality	: Reflected in the aim of Cooperation to give equal opportunity to all in 'one member, one vote' principle.
Equity	: Justice and fairness in distributing the gains of cooperative effort.
Liability	: The share of the individual member is in respect of the debts of a cooperative society on its liquidation.
Limited liability	: The share of the individual member in respect of the debts of a cooperative society on its liquidation being limited to his share capital contribution.
Member-Patron	: The member of a Cooperative society is both its consumer and patron.
Member user Identity	
Neutrality	: Co-operative Society not patronising any religion, caste or party.
Open Membership	: The membership of a Cooperative society being open to any major without any discrimination.
Patronage Dividend	: Paid to members of a Co-operative Society based on their patronage or utilisation of the society.
Primary Society	: Cooperative Society operating at the base, usually at the village level.

Surety : Guarantor

Three-Tier-Setup : Cooperative Societies operating at three levels.

Thrift : Saving

Thrift Society : Co-operative Society started with the objective of encouraging savings among the members.

Unity : Cooperative Societies avoiding competition among themselves.

Universality : The membership of a Co-operative Society being open to any major group without any discrimination.

Unlimited Liability : On the liquidation of a Co-operative Society the liability of a member to the debts of the Society being joint and several.

Voluntaryism : Not resorting to compulsion in enrolling members as well as in their continuance in the Society.

UNIT-11 : MANAGEMENT OF COOPERATIVES

Contents

11.0 AIMS AND OBJECTIVES

This unit aims at giving a descriptive analysis of how the cooperative societies are managed right from the stage of formation and to their effective functioning.

After studying the unit, you will be able to :

- describe the procedure of formation of cooperatives
- explain the management & cooperatives
- explain the structure of cooperatives

11.1 INTRODUCTION

In the previous unit, we discussed an overview of co-operation. In this unit, the formalities relating to the formation of a co-opertive society and its managerial aspects are dealt with. The members who wish to form themslves into a co-operative society, have to approach the deputy registrar of co-operatives to know the formalities to be completed to register a co-operative society. The co-operative society is managed by general body and board of directors.

11.2 FORMATION OF A CO-OPERATIVE SOCIETY

11.2.1 Procedure

Any group of persons having some common need like credit supply, marketing or distribution can organise themselves into a Co-operative Society in order to eliminate explotiation by middlemen. The procedure followed in the formation of a Co-operative is briefly discussed below.

The persons desirous of starting a Co-opercative Society,approach or write to the Deputy Registrar or Assistant Registrar of Co-operation in the area. The officer then refers the proposal to an Administrative Inspector of the Department. The Inspector visits the place and explores the scope of organising the society. He submits his report. The officer, after examining the report, directs the Inspector to organise the society. The Inspector visits the place and convenes a preliminary meeting of the promoters.

At the meeting, the application is prepared in the prescribed form furnishing details such as the name of the Society, headquarters, area of operation, postal address, population covered, names and addresses of the promoters. It is to be signed by at least 10 persons (In some states, the minimum number of signatories has been raised to 25). Then the bye-laws of the Society are prepared based on the model bye-laws. The bye-laws should be in accordance with the provisions of the Act and the Rules. The varios clauses of the bye-laws are to be read and approved at the meeting. The promoters present at the meeting sign two copies of the bye-laws and the application. A separate schedule of particulars regarding the addresses, assets and liabilities of the promoters is prepared in duplicate and signed by them. A chief promoter is elected at the meeting. Members of an Interim Committee are also elected. A resolution is passed at the meeting requesting the Deputy Registrar to register the Society at an early date. The initial share amount which should not be less than the minimum amount prescrived by the act is collected from the promoters. The amount collected is remitted into the District Central Co-operative Bank. The Inspctor submits his report to the Deputy Registrar along with the promoter's applicaton for registration, copies of bye-laws, the schedule of particulars of the promoters, copies of resolutions passed at the meeting, the names of Interim Committee members and the amount of initial share capital paid with the chalan number and date.

The first general meeting is convened to transact the following business :

i) that the application and the bye-laws are in conformity with the Co-operative Societies Act and Rules and

ii) that the proposed Society has reasonable chances of success.

Then he consults the Central Bank and the Federal Society concerned, if any. After all these formalities are over, the Deputy Registrar registers the Society with its bye-laws and issues a Registration Certificate.

The first general meeting is convened to transact the following business :

i. To read and record the Registration Certificate, the bye-laws and the names of members of the Interim Committee.

ii. To admit the promoters as members of the Society.

iii. To get affiliation to the Central Bank and the concerned Federal Society.

iv. To elect delegates to the above Federal organisations.

Then a current account is opened with the Central Bank through a resolution passed at the meeting of the Interim Committee. Two persons among them are authorised to operate the account. Then, shares are taken in the Central Bank and in the Federal Soceity concerned. This completesthe process of formation of the Society.

11.3 MANAGEMENT OF A CO-OPERATIVE SOCIETY

A Co-operative Society is democratically managed by the members. It has two organs of management, the General Body and the Board of Directors.

11.3.1 General Body

This is the supreme body in a Co-operative Society. The ultimate authority in all matters relating to the administration of the Society rests with it. It makes or amends the bye-laws of the Society. It elects the Board of Directors. It approves the annual report and decides the disposal of net surplus. It operates through general meetings and makes decisions by passing resolutions by majority votes. In elections and also in making decisions, one member has only one vote.

11.3.2 Board of Directors

The administration of a Co-operative Society is vested in the hands of the Board of Directors, subject to the resolutions passed in the general meetings from time to time. The directors are elected by the members of the general body from among themselves as prescribed in the bye-laws. It exercises such powers as are prescribed in the bye-laws. It is ultimately responsible to the general body for all its actions. It discharges its duty by periodical meetings. Decisions are made on the basis of majority vote. Each member has only one vote.

The Board of Directors elects office-bearers such as the President and the Vice-President from among the directors and entrusts them with the management of the Society's affairs. Subject to the budget allottment, the Board appoints the chief executive who is assisted by paid staff and entrusts the day-to-day adminstration to him.

A sound and favourable relationship between the Board and the Chief Executive is essential for the success of a Co-operative Society. This relationship should be based on the proper division of functions between them. In order to promote efficiency without impairing members' democratic control, the Board should confine itself to the formulation of policies, appointment of executives to implement those policies and the supervision and evaluation of their performance.

The Board has the responsibility of managing the Society in the best interest of all the members of the Society. It has to understand the needs and the general will of the members and plan accordingly the functions of the Society. It has a number of features distinct from the Board in Joint Stock Companies. The Board in a Co-operative Society consists of mostly laymen with little formal education. Therefore their understanding of the rules, procedures and byelaws is likely to be limited though they are expected to have a very good knowledge of them. This necessitates the appointment of a Chief Executive with a high formal education who can guide the directors in the proper way in the decision-making process. In the election to the Board or in decision making, one member has only one vote. Proxy is not allowed as in Joint Stock Companies.

For reasons cited above, generally an official of the Co-operative department of the State Government is deputed to run a Co-operative Society. Though this is very useful for the directors in formulating policies in tune with the provisions of the Act and Rules, these deputationists are not independent. Hence the status of the Co-operative Society becomes subservent to Government. That is the reason why most people consider Co-operative Societies as Government agencies rather than their own organisations.

The success of a Co-operative depends very much upon the members' awareness and solidarity. Hence the Board should take steps for educating the members and improving their skills and latent talents. It should aim at instilling faith in Co-operation in the minds of the members.

The resources available in a Co-operative Society are limited. Therefore the Board should make every effort to optimise the utilisation of the available resources. It should undertake long range planning for stability and growth in the context of changes in the market, technology and evnironment.

The Board is also expected to be a vigilance committee i) for safeguarding the funds and assests of the Co-operative Society and ii) for ensuring the effective performance of the Co-operative Society by a) establishing suitable management systems, b) providing in built checks and balances and c) comparing the results with the standard set.

However, the Board should not interfere in day to day management of the Society which is the responsibility of the Chief Executive and his team. The Board should frame policies and allow the Chief Executive to implement them.

11.3.4 Functions of the Board in a Co-operative Society : The Board of Directors of a Co-operative Society has the following functions :

Selection of the Chief Executive.
Determining the terms of service of the Chief Executive.
Formulating General Policies regarding prices, dividends and reserves.
Deciding on the bonus and rebate to members.
Approving budgets.
Formulating a plan of development for the future.
Reviewing trade and other trends to give information to members and employees.
Maintaining continuous liaison with members, customers and outsiders.
Establishing standards for performance.
Evaluating performance vis-a-vis standards.
Recommending appropriate action for the future based on performance evaluation.

11.3.5 President of the Society

The Chairman of the Board is called the President. The President has a special role to play in a co-operative Society. He acts as the liaison between the Board to the Executive. He ensures proper implementation of such policies. He reports to the Board the extent of implementation of the policies and the deviation, if any. He enables the Board to take corrective actions.

The President also acts as the liaison between the Board and the members. He senses the pulse of the members by listening to their views and communicates them to the Board. He enables the Board to formulate policies in accordance with the member's views. He also communicates the policies formulated by the Board to the members and convinces them about their effectiveness.

The President acts as a liaison between the Co-operative Society and the public. He provides an image to Society. His views and actions reflect on the Society. He provides inspiration to the other directors, members and employees of the Co-operative Society.

11.3.6 Functions of the President : In order to play the above roles, the President performs the following functions :

1. President over the meetings of the Board and the General Body.
2. Initiating discussions in the meetings.
3. Answering questions and queries.
4. Representing the Co-operative Society to the Government and the Central organisation.
5. Examining the proposals of the Chief Executive and placing them before the Board for discussion and decision.
6. Examining proposals for the long range planning and development of the Society and placing them before the Board for decisions.

Check your progress-1

What do you mean by a general body?

11.4 Structure of Co-operatives

11.4.1 Federal and Unitary Structure

In any branch of Co-operation there is generally a multi-level structure. The organisation at the primary level itself will not be able to render effective and economical service to the members. It needs the support of higher level organisations for this purpose. Thus a multi-level, structure emerges. The main point of debate is the issue of structure-should it be federal or unitary?

Federal Structure : Independent organisations are started at every level in the federal type of structure. The Apex Society, Central societies and each of the primaries are independent organisations. The society at each level has its own Board, President, etc. It follows its own policy. At each level, the society is federated into the next higher lvel of society with due representation in the general body of the latter. Thus a higher level federation is owned and controlled by its member-organisations. For example, the short-term co-operative credit system consists of primary societies at the rural base, their federal co-operative central Banks at the district level and Apex federation at the State level. This federal system conforms to the primary Co-operative principles of democratic control.

Merits : Its merits are : 1) Importance of the primaries is better recognised. 2) Each unit manages itself. Hence the Central Society is relieved of the burden of managing a number of primary units. 3) Each unit can independently follow its own policy suitable to local conditions. 4) Each unit can maintain its Co-operative character, as it is a compact organisation. 5) As primary units confine their operations to small areas, there will be better interaction and understanding among the members of the primaries. This system is suitable when the areas covered are vast.

Unitary Structure : In this structure, there is a large Central Society with its branches at the primary level. e.g., a State/District level Co-operative may operate, through its own branches at lower levels. This is a monolistic structure. This is convenient for an organisation serving a compact area, eg., an urban co-operative bank, but it is not suitable for an organisation convering a wider area like a district or state. In a larger unitary organisation, the co-operative character cannot be maintained and it cannot be responsive to the varying needs of the local people.

Check your progerss - 2

What type of business is transacted in the first meeting?

11.4.2 Employer-Employee Relationship

Co-operation has emerged as a solution to the problem of exploitation of labour in the Post-Industrial Revolution era. Therefore there exists a cordial relationship between the Societies and their employees.

Reasons for Cordial Relations : i. Co-operative societies are generally started by men of limited means who identify themselves with the interest of labour. ii. Recruitment is generally confined to members who identify themselves with the society. iii. Employees are represented on the Board. This helps in developing mutual understanding. iv. The Board, responsible for management, is more easily accessible to workers in Co-operative Societies than in companies. v. There is a strong system of arbitration in Co-operaive Societies. vi. The surplus is distributed equitably giving very little scope for disputes.

However the degree of relationship depends on the type of Society.

i. In Co-operative Societies started by labourers, there is a high degree of cordiality. For example in Societies such as Labour Contract Societies, Industrial Co-operatives, the employees themselves are their employers. Hence there is no employee-employer conflict.
ii. In other Societies, the employees are mere wage earners and hence there can be no employer-employee conflict in them.

11.4.3 Area of operation

In the early days when Co-operative Credit Societies were started the "one village-one society" principle was followed. As such Societies were not able to function as viable units. The All India Rural Credit Survey Committee recommended the establishment of one Society for a group of villages covering a population of about 5000 within a radious of 2-3 miles. Accordingly large-sized Co-operative Banks were started. This leads to the next question. What should be the area of operation? When the area is very large, the members may not know each other. Hence the co-operative character is lost. If the society covers a small area it may not be viable as an economic organisation. Therefore it is necessary to strike a balance between the Co-operative character and viability.

11.4.4 Distribution of Profit

This distribution is governed by the provisions of the bye-laws. The profit is allocated towards Reserve Fund, Co-operative Education, Common Good Fund, dividend on share capital, patronage dividend and other specific reserves as per the percentages prescribed in the bye-laws.

11.5 SUMMING UP

The cooperative societies have come to stay with the common man. Having identified the need and the importance, the cooperative movement has stepped in to every walk of life, particularly the poor and weaker sections.

The formation of cooperative society is undertaken by a group of persons having same common needs like credit supply, marketing or distribution etc.

The persons who are willing to form the society should apply to the registrar of the society. After that, the inspector visits the place and holds a meeting with the promoters. The registrar register the society after he is satisfied on all the issues. Once the society is registered it is to be managed by somebody so there is a general body and board of directors. The general body is a supreme body consisting of all the members. The board of directors are elected by the general body and they elect the president and the vice-president to run the daily activities of the society. The society should maintain good relationships with the Government and the employees. The profits of the organisation are distributed as per the bye-laws.

11.6 CHECK YOUR PROGRESS : MODEL ANSWERS

1. This is the supreme body in a cooperative Society. The ultimate authority in all matters relating to the administration of the society rests with it. It makes or amends the bye-laws of the society. It elects Board of directors. It approves the annual report and decides the

disposal of net surplus.

2. The business transacted in the first meeting is :
   a) To read and record the Registration certificate, the bye-laws and the names of interim committee.
   b) To admit the promoters as members of the society.
   c) To get affiliation to the Cetntral Bank and the concerned federal society;
   d) To elect delagates to the above Federal organisations.

11.7 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. Explain the procedure followed in the formation of a cooperative society.
2. Compare the Federal and Unitary type of Cooperative structure.
3. Explain the management of co-operatives.
4. Is Co-operative Movement in India a Spoonfed child?

B. SHORT QUESTIONS

6. What are the functions of a Board in a co-operative society.?
7. What are the functions of the president.?
8. Explain the two structures of co-operatives.?

11.8 RECOMMENDED BOOKS

1. Hajela T. N. 'Principles, Problems and practice of Cooperation', : Shivalal Agarwala and company, Agra 1981.
2. Krishnaswamy O.R. 'Essentials of Commerce' : Eagle press publications Division, Madras 1981
3. Krishnaswamy O.R. 'Fundamentals of Cooperation', : S. Chand and Company Ltd., New Delhi 1978.
4. Mathur B.S. 'Cooperation in India', : Sahitya Bhawan, Agra 1982
5. Reddy P.N. and Gulshan, S.S. 'Principles of Business Organisation and Management' : Eurasia Publishing House (P) Ltd., Nea Delhi 1981.

11.9 GLOSSARY

Apex Society : The federation of Co-operative societies operating at the state level.

Board of Directors : The body responsible for the management of a cooperative society. Generally, the Directors are elected at the General Body Meeting.

Bye Laws : The rules and regulations governing the management of a cooperative society.

Common Good Fund : Allocation from the profits of a cooperative society towards this fund which can be used by the members for their common benefit.

Debentures : Bonds issued by Land Development bank in acknowledgement of its borrowing from others.

Democratic Management : The system of management of Cooperative Society with (one member, One vote principle.

Federal Structure : The primary cooperative societies having an independent central society.

General Body : Consisting of all the members of a co-operative

		society and having the ultimate authority in the management of the society.
Interim Committee	:	Committee elected at the preliminary meeting to arrange for the Registration of a cooperative society.
Managing Committee	:	The body responsible for the management of a cooperative society. Generally, the members are elected at the General Body meeting.
Master Weaver	:	Person who gets his yarn woven by other weavers and by lending money to them keep them bond to him.
Maximum Borrowing Powr	:	The ceiling on the borrowing of a member from the Co-operative society.
Proportional liability	:	The share of the individual member towards the debts of a co-operative society on its liquidation being in a certain proportion to his share capital contribution.
Two-tier Setup	:	Co-operative societies operating at two levels
Unitary Structure	:	The primary Co-operative Societies being the branches of the Central Society.

UNIT-12 : TYPES OF CO-OPERATIVES

contents

12.0 AIMS AND OBJECTIVES

The aim of this unit is to introduce the two types of co-operative societies viz., Credit and non-credit

At the end of the unit, you should be able to :

- Identify the way in which the cooperative societies can be classified,
- distinguish between credit and non-credit co-operative societies,
- list out the various credit and non-credit co-operative societies,
- draw a comparision between the various formsof organisation.

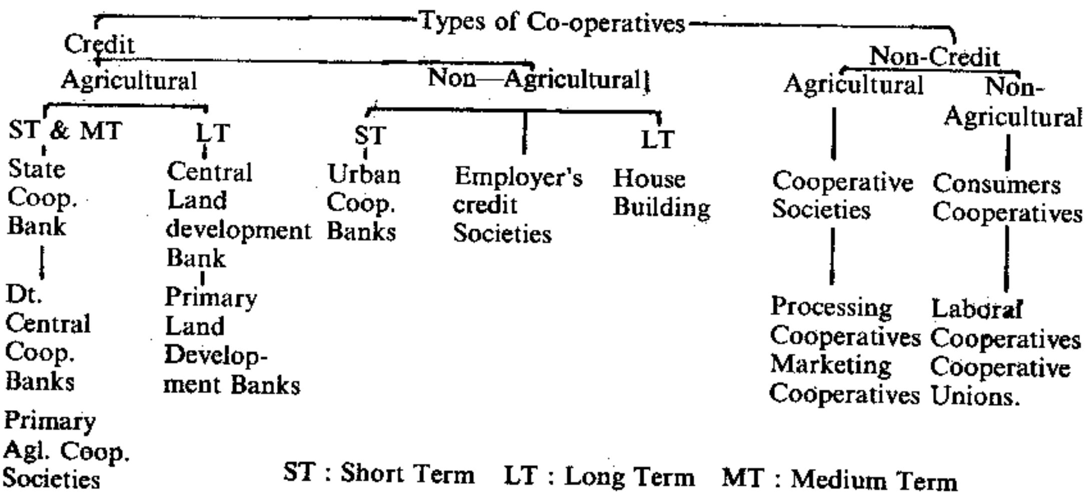
12.1 INTRODUCTION

The previous unit was centred on the discussion of the management of cooperative and this unit indicates the different types of cooperatives.

Co-operative societies are started in different fields to fulfil the needs of different sections of people and to promote their moral and social well-being. The needs of different sections of people vary, accordingly there are different types of Co-operative Societies.

Co-operative Societies can be broadly divided into two major categories Credit and Non-Credit. Each category in turn can be divided into Agricultural and Non-agricultural.

Chart.6 : TYPES OF CO-OPERATIVES



ST : Short Term LT : Long Term MT : Medium Term

12.2 CO-OPERATIVE CREDIT SOCIETIES

12.2.1 Introduction/Credit Societies are started by persons who are in need of credit. These Societies provide credit to their members at a reasonable rate of interest. They collect the savings of the members in the form of share capital and deposits. They also borrow from outside sources and their Apex Societies. The resources so raised will be used to grant loans to their members at a fair rate of interest.

The State Co-opeartive Bank is an Apex organisation at the State level. It is a Federation of Central Co-operative Banks. It co-ordinates the activities of District Central Co-operative Banks. It grants loans to the Central Co-operative Credit Societies operate at the bottom of the three-tier set up for Co-operative credit.

The Primary Credit Societies are classified into two types, the Agricultural Credit Societies and the Non-agricultural Credit Societies.

12.2.2. Agricultural Credit Societies

Agricultural Credit Co-operatives are started to provide short-term and medium-term finance to the farmers to meet expenses in cultivation. The short-term loans issued by these Societies are callled crop loans. The duration of the loans is one crop season ranging from 4 to 8 months. These loans are sanctioned against sureties. Loans are disbursed both in cash and in kind in the form of seeds, fertilizers and pesticides. The borrowing members should give an undertaking that he will sell his produce only through the Society. The loan amount will be deducted from the sale proceeds. Besides lendig, these Societies also supply essential goods and make available improved agricultural implements. They promote thrift among the local people by accepting deposits from members and non-members.

There are four types of Primary Agricultural Co-opeartive Credit Societies. Besides the ordinary ones with unlimited liability there are Multipurpose Co-operative Societies and Service Co-operatives and large sized Rural Banks with limited liability covering a group of villages with a population of about 5,000.

12.2.3. Land Development Banks

Land Development Banks are started to provide long term finance to agriculturists. They issue loans mainly for land improvement such as digging wells, installing pumpsets, the purchase of agricultural machinery like tractors and for land reclamation. They lend against the mortage of land. These loans are repayable within 10 or 15 years in half yearly instalments.

There is a two-tier set up for the provision of long term credit to agriculture. Central Land Development banks function at the State level while at the taluq level, there are Primary Land Development Banks. The Central Land Development Banks raise funds through the issue of Debentures and loans from State Governments, State Bank of India and Reserve Bank of India.

12.2.4 Non-Agricultural Credit Societies

Employees of industrial units, small traders, artisans and people of low income groups in towns and cities start Credit Societies. A few examples are Co-oparative Urban Banks, Thrift Societies, Employees Credit Societies, Industrilal Co-operative Banks and House Mortagage Banks.

12.2.5 Urban Banks

These banks, also called City Co-operative Banks, are started for providing short-term credit to small traders and people of low income groups. They also undertake all the functions of commercial banks. Though the bulk of the loans issued by them are jewel loans, they also lend against bills and hypothecation. They also accept safe custody deposits. They promote thrift and savings by collecting the small savings of people of low income. They raise funds through share capital, public deposits, and borrowings from Apex Banks.

12.2.6 Thrift Societies

These societies are started with the objective of inculcating a sense of thrift and saving in people of low income by collecting their small savings. Such collections may be made daily, weekly, fornightly or monthly. These Societies repay such deposits with interest after the stipulated period. The members are also permitted to avail credit facilities against such deposits.

Check your Progress-1
What are thrift societies?

12.2.7 Employees' Credit Societies

Employees in industrial and other undertakings in town and cities are victims in the hands of money lenders. These Societies are started in order to protect the employees from the exploitation by the latter. Membership of these Societies is confined to the employees of a particular organisation. These Societies provide short-term loans to their members and collect deposits from their members and non-members. The members also subscribe to the share capital of their societies. These Societies also depend on borrowings from the District Central Co-operative Banks Loans are issued on gurantees and they are recovered through deductions from the monthly earnings of the employee-members. These Credit Societies also involve themselves in activities promoting the welfare of the members.

12.2.8 Industrial Co-operative Banks

Small scale and cottage industries play a pivotal role in developing the economy of the under developed countries. Hence the development of the Small Scale and Cottage industries is very essential. Industrial Co-operative Banks are started with the objective of providing short-term, medium-term and long-term finance to Small-Scale and Cottage industries. They also lend money to and promote thrift among the members. They raise finance through share capital, deposits from members and public borrowings from Reserve Bank of India, State Bank of India and Government.

Co-operative Housing Societies

Co—operative Housing Societies are formed in order to provide housing or accommodation to the members. Most of these Societies operate in urban areas. There are different types of Housing Societies. Some of them provide loans to their members and leave the selection of site and the construction of houses to them. Loans are repayable in easy instalments. These Societies are called House Mortgage Banks.

Some of Socities acquire land, plan the layout and construct houses and later allot the houses to the members. The cost of house is collected in instalments. Some Societies sell the houses on hire-sale basis. Housing Co-operatives raise finance through share capital, reserves, borrowings from Central Government, State Government, State Co-operative Housing Societies, Life Insurance Corporation, Urban Developement Corporation and the National Cooperative Housing Federation. A new scheme called village Housing Project has also been introduced in order to ensure the successful implementation of the scheme to construct houses. They subsidise the cost of the house besides lending money for the purpose.

12.3.NON-CREDIT SOCITIES

Co-operation has branched out in many fields. There are many Non-Credit Co-operative Societies to promote the varied interests of human life. A few examples are Consumer Co-operative Stores, Producers' Co-operatives Marketing Co-operatives, and Co-operative Farming Societies.

12.3.1 Consumer co-operative Stores

Consumer Co-operative Stores are started for selling household goods to the members at a reasonable Prices. Their objective is to protect the members from the evils of unfair trade and steep rise in prices. These Stores buy their requirements from the producers through the Apex Societies so as to avoid the profiteering and adulteration of goods by middlemen. Hence the members of the Stores are able to get better quality goods at low prices. Thus Consumer Co-operative Stores are retail trading units.

The consumer Co-operative Stores purchase goods from the District Central Co-opeative Stores which, in turn, buy from the State Consumer Co-operative Federation. The State Federation purcahses a few goods directly from the producers and a few others from the National Co-operative Consumer Federation. As these Apex Societies buy on behalf of several Primary Stores, they place bulk orders and enjoy the advantages of large-scale buying. A few Apex Societies themselves produce some goods through their own processing units.

Different types of Consumer Stores are started by differnt types of consumers. They are Rual Co-operative Stores, Urban Co-operative Stores, Womnes' Co-operative Stores and Co-operative Supermarkets. Rural Stores are started to supply goods to consumers in towns. Women Co-operative Stores are started in order to satisfythe requirements of women. Seperate Stores are started for schools and colleges, to sell text books, note-books and stationery to the students. In order to project people of fixed income groups from exploitation, Emplyees' Co-operative Stores are started in industrial units. Their membership is confined to the employees of particular industrial units. These Stores sell goods to members on credit and recover the dues through deduction from the monthly earnings of the members.

Co-operative Supermarkets are popular in India. They are large-sclae departments stores. They deal in various kinds of consumer goods.

In general, the Consumer Co-operative Stores provide the following benefits to their members:

(i)They sell comodities at low prices as they aim at replacing middle men. They obtain the benefit of large-scale buying, (ii) The commodities supplied by the Sotres are better in quality and free from adulteration becuase there is no chance for unfair trade in Co-operatives, (iii) Weights and measurements used are perfect in these stores and (iv) The Co-operatives arrange for better packing also.

Check Your Progress-2

Mention any four names of consumer cooperatives.

Producers' Co-operative Societies

Producers' Co-operative Societies are called as Industrial Co-operatives. Small producers and artisans are members of these Societies. These Societies are formed in order to protect the small producers and workers from the exploitation of powerful capitalists.Theobjectives of these Societies are to provide credit facility, to supply raw materials and to market the products produced by them and to help the members to buy machinery on a hire purchase basis.

There are two types of Industrial Co-operatives. In the first, the Society procures raw materials and distributes them to the members. The members work in their houses and sell the finsihed goods through the Scoiety., The Society gets a better price for the products from the members. In addition, the Society provided the finance, tools, equipment and machinery required by the members. In the second type the Society maintains a work shed with the necessary equipment, machinery and raw materials. The members are expected to go and work in the Society work shed. They get wages for the work they do. At the end of the year the profit is distributed as bonus in proportion to the wages earned by members.

Industrial Societies raise finance through share capital, and loans from Industrial Co-operative Bank. Government and other financial institutions. Long-term financial requirements are met by borrwings from the State Directorate of Industries, State Finance Corporation, National Small Scale Industries Corporation, Khadi and Village Industries Commission and other bodies. There are Industrial Co-operatives in weaving, tanning, pottery, oil porcessing. spinning. handicrafts, chemical engineering, ect. There are also Co-operative work shops to attend to serving functions.

12.3.3 Co-operative Marketing Societies

Agricultural producers are exploited when they market their proucts. Middlemen take away a larger portion of the pirce paid by the consyumers.The Marketing Societies are started in order to protect such producers.

These Socities arrange for marketing the members' products at favourable price. These Societies provide storage, processing, grading and standardisation facilities. They grant advances against the pledge of goods.

There are Federations of Marketing Co-operatives at the district, state and national levels.

12.3.4 Co-operative Farming Societies

Subdivisions and fragmentation have affected the land holdings of farmers. Economics of large sclae operations cannot be derived by small-holders. Farming Societies are formed to promote the welfare of small holders.

There are various types of Co-operative farming societies, viz,
Co-operative better farming society
Co-operative Tenant farming society
Co-operative Joint farming society
Co-operative Collective farming society

12.3.5 Co-operative Better farming society

The members own their land and cultivate their lands individually. The Society undertakes supply of inputs such as seeds, fertilizers and implements and some of the modern machinery which can be used commonly by all the members. The Society provides facilities for processing, grading and storing. Later, the Society arranges to sell the produce.

12.3.6 Co-operative Joint Farming Society

This type of Society pools the members' land and other resources and arranges for joint cultivation. The land ownership rests with the individual members. Members get rent for the land and wages for the work done. The profit of the Society is distributed among the members on the basis of their wage earnings. The members are free to withdraw their land from the common pool whenever they wish to do so.

12.3.7 Co-operative Tenant Farming Society

This type of Society owns land or takes land on lease from an organisation. The land is divided into economic holdings and distributed among members for cultivation on lease. The member tenants buy seeds and fertilizers, etc., through the Society and market their produce through the Society. The profit of the Society is distributed in proportion to the members' patronage.

12.3.8 Co-operative Collective Farming Society

In this type of Co-operative, the ownership of the land rests with the Society, and cultivation is done jointly. The members are paid wages and patronage dividend out of the surplus in proportion to the wages earned by them.

The Co-operative Farming Societies are most helpful to small and marginal farmers and enable them to get the advantages of large-scale operations.

12.3.9 Other types of co-operative societies

In addition to the above types of Societies, there are various other types of Societies such as Transport Co-operatives, like Autorikshaw Co-operatives, Motor Transport Co-operatives, Washerman Co-operatives, Fishery Co-operatives, Dairy Co-operatives and Poultry Co-operatives. All these Societies aim at promoting the welfare of their members.

12.4 · A comparative study of forms of organisation: A tabular Statement

Factors	**Sole Trader**	**Partnership firm**	**family firm**	**Joing-stock company**	**Co-operative society**	**Public corporation**
1. Dominating factor	Freedom of action	Mutual under standing and trust	family	Union of capital	Union of persons	state policy
2. Creation	Individual capability to to start business	agreement	operation of Hindu law	Incorporation under Companies Act	mutual association	sepcial statute
3. Legal entity	No	No	No	Yes	Yes	Yes
4.Continued existence	No	No	No	Yes	Yes	Yes
5. Objective	Profit	Profit	Profit	Profit	Promotion of members' welfare	Social objective
6. Ownership	Sole propiertor	Partners	family	share holoders	member-users	State
7.Number of members	Only one person	Not exceeding 10 in banking, 20 in other lines	all members of the family	2 to 50 in private companies 7 and above in public companies	10 and above	No share holoders
8. Transfer of shares	does not arise	Not transferable	Not transferable	Transferable in public companies	Not transferable	does not arise
9. Liability of share holders	Unlimited	Unlimited	Unlimited in the case of Karta	Limited	Limited	
10. Registration under an Act	not necessary	Not compulsory	No	Compulsory	Compulsory where co-operative society Act exists	
11.Management	proprietor himself	Partners	Head of the family	Board of Direcotrs elected by Share holders.	Board of Directors elected by members	Board of Directors appointed by govern ment

12. Voting right of share holders				proportion to shares	one member one vote	
13. Distri-buttion of profit	Entireprofit goes to sole proprietor.	as per agreement		in propor tion to paid-up capital	in propor tion to patro nage	
14. Social aspect	No	No	No	No	Yes	Yes

The above table gives a detailedcomparisonof different forms organisations.

12.5 SUMMING UP

The cooperative societies are started in the various fields which are mostly needed by the people. The cooperative societies are broadly divided in two types:

1. Credit Societies; 2. Non-credit societies. Again these societies are divided into agricultural and non-agricultural. The group of credit societies consist of the land development Banks, urban banks, employees credit societies, Industrial credit societies, Housing societies etc. The non-credit societies consists of consumer cooperative societies.They are very important. They do both wholesale and retail trade. Different consumer stores are started namely Rural stores, Urban stores, Womens' stores, Student's stores, employee stores, and supermarkets . Among these, the super markets are very popular in India.

12.6 CHECK YOUR PROGRESS: MODEL ANSWERS

1. These societies inculcate a sense of thrift and saving in people of low income by collecting their small savings.
2. Rural cooperative stores, women's cooperative stores, Employees cooperative stores cooperative super markets.

12.7 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. Discuss the advantage of consumer Co-operative Stores.
2. Explain the working of Co-operative Farming Societies.
3. Explain the role of Co-operative Credit in financing agriculture

B. SHORT QUESTIONS

4. What are the objectives of Co-operative Credit Societies?
5. Mention any four types of Consumer Co-operative Stores.
6. What are the objectives of Co-operative Marketing Societies?

12.8 RECOMMENDED BOOKS

1. HajLa T.N.' 'Principles, Problems and Practice of Cooperation : Shivalal Agarwala and Company, Agra 1982.
2. Krishnaswamy O.R. 'Essentials of Commerce, : Eagle Press Publications Division,. Madras 1981.
3. Krishnaswami, O.R. 'Fundamentals of Cooperation, : S. Chand and Company Ltd., New Delhi 1978.
4. Mathur B.S. 'Cooperation in India, : Sahitya Bhawan, Agra 1982.

5. Reddy P.N. and Gulshan, S.S. — 'Principles of Business Organisation and Management, Eurasia Publishing House (P) Ltd., New Delhi 1981.

12.5 GLOSSARY

Agricultural Credit Society :	Co-operative society lending money for agricultrual purposes.
Central Land Development Bank :	Cooperative Bank operating at the State levels which issues long-term loans for the development of land
Central Society :	The organisation of the primary coperative societies operating at the District level.
Cooperative Farming Society :	Cooperative society for the joint cultivation of land.
Co-operative Marketing Society :	Co-operative society organised in accordance with the of principles of cooperation.
Crop Season :	The period in which a crop is raised.
Crop Loan :	Loan issued by Co-operative Credit society for raising a coop.
Employee's Credit Society :	Cooperative society started by the employees of Government, business or industrial establishment for securing credit from among theselves.
HIRE-PURCHASE :	Purchasing of anything for which the price is payable in instalments.
HOUSE MORTGAGE BANK :	Co-operative bank lending money against the morrgage of house.
HYPOTHE-CATION :	A charge against the stock of raw material, work in porgress and finished goods.
INDUSTRIAL COOPERATIVE BANK :	Co-operative Bank issuing loans to industrial cooperatives, and small scale and cottage industries.
INDUSTRIAL CO-OPERATIVE SOCIETY :	Co-operative society started by small producers and artisans.
Land Develop-ment Bank :	Co-operative Bank issuing long term loans for the developemtn of land
Multipurpose Co-operative Scoeity :	Co-operative society which combines supply and marketing functions along with those of credit.

Non-Agricultural Credit Society	:	Co-operative society lending money for purposes other than agricultural use.
Non-credit society	:	Co-operative society whose objective is anything except credit.
Primary Land Development Bank	:	Co-operative bank issuing long term loans for the development of land operating at the base generally at the taluk level.
Producer's Co-Operative Society	:	Co-operative society for helping small producers, farmers and artisans in their production activities.
Service Co-operative Society	:	Co-operative Society with service functions such as supply and marketing besides credit.
Urban Bank	:	Co-operative Banks opertaing in towns and cities.

BLOCK - 3 : STATE AND INDUSTRY

UNIT - 13 : STATE REGULATION OF BUSINESS

Contents

13.0 AIMS AND OBJECTIVES

This unit describes the Government regulation over the business. After going through this unit you should be bale to :

- Identify the need fot Government regulation over the business

Explain the various forms of Government control over business

13.1 INTORDUCTION

Growth of Industries is a sign of economic development of the country. These industries are various in nature and they are established for the purpose of promoting business and purity in supply of goods produced by them. In the absence of any control over these industries, the growth might take diversion of resorting to higher prices and neglecting the social responsibility of business. It is in this context this unit gives an account of State regulation over business which includes the different forms of Government control, industrial licnecing, etc.

13.2 NEED FOR STATE REGULATION

In the early years of industrial revolution. Capitalism and "laissez faire" policy followed by the Government led to unchecked growth of monopolies and big business. Successful business units developed into large units. Small and not so successful units were either liquidated or merged with big units. Thus the combination movement led to monopoly and big business Industries also tended to concentrate in a few places which had some natural advnatages in raw materials and being near to markets. Other places without such distinct advantages did not develop at all. Thus the economy tended to concentrate in a few places. In order to check such concentration and to ensure balanced development of various regions, Government had to regulate business and industry.

At present the economy systems in various countries can be broadly divided into the following three systems:

1.Capitalism in which the Government has no role in business and industry.
2.Socialism in which the state owns means of production. There will be only state undertakings and no unit will be in the private sector.

3Mixed economy which is a compromise between the two. In this system the state takes an active role in business and industry, while allowing an equally big role to the private sector, Most of the countries follow this system, though the extent of state participation in industry may vary. In this system,the state plays a dual role. On the one hand, it acts as an instrument to aid and benefit industry with the object of inducing and accelerating the growth of the economy. In this role, the state provides finance and facilities to industrial entrepreneurs and tries to promote their interests through policies like protection and export promotion. In the second role, the state acts as a restraining force on business curbing the anti-social aspects of business. This may be described as the regulatory role of the Government.

13.3 Objecitves of Government Regulation

The objectives of state control over the private enterprise are as follows:

1. To serve and optimise the utlisation of natural resources.
2. To promote industrial growth in a way that regional disparities are reduced to the minimum.
3. To lay the base for development of such industries which will lessen and ultimately eliminate country's dependence on other countries.
4. To give direction to economy along the desired line to bring about qualitative change in the society.
5. To ensure more equitable distribution of income and wealth.
6. To check monoplies and concetration of economic power and to avoid exploitation of workers and consumers.
7. To protect public health, safety and welfare.

13.4 FORMS OF GOVERNMENT CONTROL

13.4.1 Forms of control

General direction and regulation of investment activity in the private enterprise.This is achieved through economic planning at the national level.
Industrial policy to determine priorities of different segments of the economy.
Regulation of investment, location, size and expansion of business and industrial undertakings through licensing.
Regulation of prices of commodities and industrial products through legislative authority and systematic investigations into cost structure and mark-ups.
Regulation of monopolies and unfair or restrictive trade practices through legislation.
Regulation of wages and bonus for employees in the private sector to minimise exploitation, ensure reasonable standard of living and maintain peace and harmony in industry.
Regulation of corporate management.
Regulation of specific forms of business activity like speculation in shares and commodities or imports/exports, etc.

13.4.2 General Regulation of Business Activity -Planning

General regulation of private investment is exercised through two methods, economic planning and Industrial Policy. The need for economic planning arises due to scarcity of resources in relation to the desire for quick economic and social development. In totalitarian economies, the economic activities are centrally planned and controlled by the State. However, planning is not confined to totalitarian States alone. In countries with mixed economies too planning is followed.

13.5 INDUSTRIAL POLICY RESOLUTIONS

The Industrial Policy of the Government reflects the attitude of the State towards industrial development. It lays down priorities regarding relative roles of large and small industries in public and private sectors.

13.5.1 Industrial Policy Resolution . 1948

The first Industrial Policy Resolution passed in 1948 envisaged a mixed economy with a progressively activerolefor the state in the promotion and development of industries. It aimed at a social order where justice and equally of opportunity would be assured to all people. It was also directed at prevention of monopoly and inequitable distribution of wealth.

The industries were classified into four categories. The exclusive Government monopolies included defence and strategic industries. Basic and key industries like iron and steel, coal, air craft manufacture and ship building were included in Government controlled sphere. In this category, new industries were to be started by the state only and existing units in the private sector were allowed a period of 10 years, after which the question of nationalisation would be decided depending on their performance. The third category included industries such as chemicals, sugar and textiles, which were subject to state regulation and control without any threat of nationalisation. Other industries were left to the private and cooperative sectors. The policy recognised the importance of cottage and small scale industries in the national economy.

The main criticism for this policy was over the 10 trial period given to private enterprises in the second category which was later removed in the second Industrial Policy Resolution passed in 1956.

13.5.2 Industrial Policy Resolution, 1956

The enactment of the constitution of India, acceptance of socialistic pattern of society as the objective of social and economic policy and launching of five year plans necessitated the issuing of new industrial policy. Accordingly, the second Industrial Policy Resolution was passed in 1956.

The resolution divided the industries into the three categories. The first category listed in schedule A consisted of 17 industries like arms and ammunition, atomic energy, petroleum, coal and ship-building. These industries were left to the exclusive responsibility of the State. Schedule B contained 12 industries such as aluminimum, ferro alloys, machine tools, chemicals pulp and road and sea transport. These industries would be progressively state owned. Schedule C covered all the industries not covered in Schedule A and B. The Government would encourage the development of these industries in the private sector in accordance with the programme formulated in the successive plans.

The resolution did not seek to place the industries in watertight compartments. The government was given the freedom to undertake any type of industrial production. The significance of small scale and cottage industries was reiterated in more clear terms. The resolution recognised the need for balanced regional development. It envisaged a stariting of cooperative societies wherever possible.

After 1956, there has been no Industrial Policy Resolutuion. However, there were marginal changes announced through a few statements. The Industrial Policy Statement made in 1973, introduced the concept of Joint Sector with the help of equity participation from financial institutions. The Industrial Policy Statement, 1973, redefined a larger industrial house interms of the definition as outlined in promoties and destrictive Trade Practices Act 1969. Industrial Policy Statements, 1977 introduced the concept of tiny sector with investment upto Rs. 1 lakh in plant and machinery situated in towns with a population of less than 50,000. District Industries Centres were started to help the small scale industries with all the necessary assistance under one roof. 1980 Policy Statement redifined the small scale and tiny sectors. The limit of investment for tiny sector was increased from Rs. 1 lakh to Rs. 2 lakhs in plant and machinery and for small scale sector from Rs. 10 lakhs to Rs. 20 lakhs. Subsequently, this limit of investment in respect of small scale unit was raised to Rs. 35 lakhs.

13.6 INDUSTRIAL LICENSING

Industrial Licensing has been recognised as a major device through which the Industrial Policy of the Government is implimented. The first step in this direction was taken in 1951. The Industries (Development and Regulation) Act was passed on the basis of the Industrial Policy Resolution of 1948.

13.6.1 Objectives of licensing : The basic objectives of licensing are:

To provide for Government control over the location, expansion and setting up of private industrial undertakings.

To channel investment into the desired direction,

To promote balanced regional development,

To protect small and cottage industries,

To prevent concentration of ownership and control to common detriment,

To keep the volume of projected investment within the available resources of foreign exchange, and

To utilise available foreign credit.

13.6.2 Industries (Development and Regulation) Act 1951

Important provisions of the Act :

Control and Regulation of Private Enterprises: The Government can order investigation into the working of industrial undertakings covered under the Act. The investigation can be periodical or adhoc, if there has been or is likely to be, unjustifiable fall in the volume of production in the industry of the undertakings or when there is a marked deterioration in quality or an increase in price not justified by proper reasons. In the event of continued unsatisfactory working, the Government can take over its management.

Registration and licensing of undertakings: All the existing under takings in the industries included in the Schedule under the Act were to be registered with the Government. New undertakings covered by the Schedule are required to obtain a licence from the Government. The same applied to any susbstantial additions made to the existing licenced undertakings.

Development bodies: The Act provides for extablishment of three types of bodies as follows:

a Central Adivisiory Council comprising the representatives of industry, labour and commerce, to consider the general problems of industries and specific problems of registration and licensing and to advise the Central Government on the regulation and development of the scheduled industries.

b. Development councils in each major industry group covered by the Act are expected to suggest improvements in respect of productivity, quality of services and management. They are to recommend targets of production and to review the implementation of targets and the Five year Plans.

c. Licensing Committee, to regulate industrial development in conformity with the objects and priorities laid down in the Five Year Plans. It grants licenses for setting up new enterprises in the private sector after considering their capital and capital structure, location, plant capacity, availability of transport, technical and skilled personnel and foreign collaboraion, if any.

Check your progeress - 1.

Name three objectives of industrial licensing

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13.6.3 Procedure of licensing : The Ministry of Industry maintains three lists of indsutries which are subject to review every six months :

I. free list in which licenses are given without reference to the licensing committee.
2. merit list, in which licenses are given on merit after scrutiny by the Licencing Committee and
3. rejection list, in which applications are rejected on grounds of sufficient capacity.

It is the practice of the Licensing Committee to issue first a letter of intent, valid for a specified period and after completion of various preliminaries to give a licence. The minimum exemption limit for licensing of new undertaking was raised from Rs. 5 lakhs to Rs. 10 lakhs in 1960 and further to Rs. 25 lakhs in 1964 and now it is Rs. 1 Cr. Exemption limit is not applicable to produciton of new materials and substantial expansion of undertakings. A separate licence is requires for each such proposal.

Based on the recommendation of RK, Hazari, and the Licensing Policy Inquiry Committee the licensing policy has undergone a number of changes and the new policy statements have been made.

13.6.4 Industrial Licensing policy 1970 : 1. Exemption Limit : The exemption limit for licensing was raised from Rs. 2 lakhs to Rs. 1 crore.

2. Classification of industries : a) Core Sector : This sector includes iron and steel, non-ferrous metals, synthetic rubber, nitrogenous fertilizers, tractors, petroleum products, cooking coal, heavy industrial machinery, ship building, etc. It was decided to formulate plans for their development and sanction them foreign exchange and other scarce resources on priority basis.

b) Middle Sector : This sector consisted of industrial undertakings involving an investment of more than Rs. 1 crore but less than Rs. 5 crore. Industrial houses with assets of less than Rs. 35 Cr. were to recieve preference in the matter of granting licence in this sector. The large industrial houses were to be allowed to enter this sector only when it was necessary for reduction of costs for attaining economic size.

c) Heavy investment Sector : This covered units with an investment of more than Rs. 5 Crores and those receiving substantial assitance from the public financial instituions. The Government was to pursue a policy of active participation in the management of enterprises in this sector, which is also called Joint sector. The financial institutions would have the right to convert their loans or debentures into equity shares within a specified period.

Small Scale Sector: This sector covered industrial units having an invesment of less than Rs. 7.5 lakhs in plant and equipment. The Government would follow the policy of encouraging small scale sector.

Expansion of public Sector: New enterprises in public utilities or industries requiring heavy investment would be started in public sector. Such enterprises would also be eligible for assistance from public financial institutions.

Priority to Co-operative Sector: Preference would be given to cooperatvie undertakings in agro-based industries such as Khandasari, Jute, etc.

13.6.5 Licensing Polciy 1973 : In this statement, the classification of industries was not changed but some more industries were exempted from licensing. Large industrial houses were redefined as industrial houses having assets, along with assets of interconnected undertakings, of not less than Rs. 20 Cr. A list of 121 items of significant areas in which technological gaps exist or are likely to exist was prepared. Incentives for setting up units in backward regions were also announced.

A project Approval Board for implementing streamlined licensing system was set up. The fucntions of the board are :

To undertake detailed periodical review in respect of pending cases.

To review the programme of implementation of licences upto the stage of actual commissioning of capacity.

To provide a forum in which policy matters affecting a large number of applications woui be discussed and resolved

To directly deal with simultaneous or composite applications.

The Licensing Committee, Foreign Investment Board, Capital Goods Committee and Licensing Cum MRTP Committee were brought under the control of Project Approval Board wich is served by a Secretariat for industrial Approvals. This secretariat is responsible for:

1. receipt and procuring of applications for licence
2. issuing the final orders of the Government to each case to the apllicant within the time limit
3. monitoring the implementation of approval by enterpreneurs and assisting them in procedure matters

In October 1975, 21 more industries were delicensed. In March 1978, Government raised the ceiling for exemption from licensing from Rs 1 Cr. to Rs. 3 Crs. But companies covered by the MRTP Act, dominant undertakings and those with foreign equity exceeding 40% were not exempted from licensing.

13.7 SUMMING UP

State regulation of industry and growth of industries should go together. There should be constant check over the business by the Government. The objective of social responsibility can be achieved through this Govenment Control in the operation of business. The industrial licensing policy has become main opeative measure for a smooth state of affairs.

13.8 CHECK YOUR PROGRESS : MODEL ANSWERS

a) To channel investment into the desired direction.
b. To promote Balanced Regional development.
c. To prevent Concentration of Ownership and Control.
At present, the economy systems is various countries can be broadly divided into three.

a) Capitalism b) Socialism c) Mixed Economy

13.9 MODEL EXAMINATION QUESTIONS

A) ESSAY QUESTIONS:

1. Critically evaluate the Industrial Polcicy Resolution, 1956.
2. Review historically the Industrial Policy in India.

B) SHORT QUESTIONS:

3. What is meant by Government regualtion of business?
4. What is meant by Industrial Policy?
5. Mention two features of Industrial Policy Resolution, 1956.
6. What is meant by balanced regional development?

13.10 RECOMMENDED BOOKS

1. **Agrawal A.N. Indian Economy**, Vikas Publishing House (p) Ltd., New Delhi 1981, pp. 560., 576
2. **Barathwal R.R. Industrial Economics**, Chapter 17, New Delhi: Wiley Eastern Ltd., 1984.

13.11 GLOSSARY

Ancillary Units : Small Scale industrial units manufacturing some parts or components for a large scale unit.

Balanced Regional Development : Uniform developement of all the reiogns in the country.

Capitalism : An economic system with freedom of enterprises, private profit and property and minimum of Government interference.

Core Sector : Consists of basic industries.

Data Bank : Place where information regarding investment proposals and their progress is kept.

Distirct Industrises Centre : A place in which the small scale units can get all their requirements such as finance, consultancy and allocation of scarce materials.

Equitable Distribution of Income and Wealth : Distributing the national income and

		wealth among the citizens with jusice aiming at minimising disparities.
FERA	:	Foreign Exchange Regulation Act, 1947.
Heavy Investment Sector	:	Consists of units with investment of more than Rs. 5 cores.
High Technology Industry	:	**Industry using advanced technology.**
Industrial Licensing	:	The process of permitting the setting up, expansion, mergers, etc. of units in scheduled industries.
Industrial Policy	:	Policy of the Government with regard to the classification and and allocation of industries between public, private, cooperative and small scale sectors.
Industrial Policy Reguation	:	Resolution passed in the parliament incorporating the policy of the Government, regarding the development of the various industrial sectors.
Joint Sector	:	Consists of enterprises owned and managed jointly by Government and private investors.
Laisiez-faire Policy	:	Policy of the Government in which there is minimum of Government control and regulation of business.
Managing Agency	:	The system of managing companies through agents.
Middle Sector	:	Consists of industrial undertakings with investment between Rs. 1 cr and Rs. 5 crs.
Mixed Economy	:	An economic system in which both public and private sectors are assigned specific roles in the development of the economy.
Monopoly	:	Single seller
Totalitarian Economies	:	Socialist economies

UNIT-14 : PUBLIC ENTERPRISE

Contents

14.0 AIMS AND OBJECTIVES

This unit gives us a narrative picture of public enterprises. It highlights the role of public sector in India and gives a brief account of the limitations of Puclbic enterprises.

At the end of this unit, you should be able to

- explain the concept of public enterprise
- discuss the rationale of public enterprise
- speak out the objectives of Public Enterprises
- analyse the characteristic features of public enterprises

14.1 INTRODUCTION

In all the previous units the discussion was concentrated on different forms of organisations which are private and non-governmental in nature. This unit accounts for Public Enterprises owned by the Government itself.

The concept of 'laissez faire' dominated the nineteenth centrury. It has since then lost its appeal and popular support. The governments of to-day, far from being merely passive, observers of the economic process they once were, have emerged as active participants in it taking upon themselves the roles of protector, controller, guardian of the citizens and of enterpreneurs. In fact, there is hardly any sphere of economic activity which is not in some way or other controlled and regulated by the all powerful and all embracing structure, which is the 'Modern State'.

In countries where all industrial and commercial activities are conducted exclusively by the State, all enterprise is public enterprise. In other countries, the Government selects areas where it shall function in its own right, investing its resources and deciding upon the management pattern and personnel, and leaves the rest of industrial and commercial activity to private entrepreneurs.

14.2 Definition of public enterprise

14.21 Definitions.

"Public enterprise is an undertaking owned and managed by the Government of a country to serve the interests of its people". In Public enterprises,the Government is generally the owner. A few enterprises are owned and managed by Semi-Government bodies like Municipalities and

Statutory Boards. Though the Government is the owner of Government companies, private shareholders may also be allowed to the extent of holding 49% of the total paid up share capital.

Check your progress -1
Define public enterprise.

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14.2.2 Background

In olden days,a public enterprise was established when there was no private investment of capital in a desired sector. Circumstances in many countries compelled the Governments to develop resources and enterprises in the national interest when private capital was unable or unwilling to provide the necessary investment. A few of such cases are railways, road transport airlines and power resources. Defence production is brought under Government ownership and management for strategic reasons. In public interest, pubic utilities are also brought under Government ownership.

In recent times,public enterprises have come to be set up as a result of economic planning aiming at utilising the available resources to the maximum advantage to achieve certaion social ends. In developed countries like England, planning and public enterprises aim at correcting the shortcomings of the private enterprise. Public enterprises in such countries aim at bringing about a more equal distribution of the benefits of economic development. Developing countries seek rapid development and equitable distribution. They make palns to increase production through public enterprise in order to rise the standard of living of the people.

Public enterprises may also be started in pursuance of political and social consideration requiring public control over national resources.

This is one of the main features of socialistic countries, like Russia and China. "The socialistic state aims at the greatest happiness of the greatest number". This can be achieved by the maximization of production and equitable distribution. Socialistic countries aim at this through the nationalising of all the economic activities.

14.3 RATIONALE OF PUBLIC ENTERPRISE

Generally the public enterprise is expected to serve the following purposes, and the existence of public sector is justified on the following grounds :

14.3.1 Need for Planned Economy

Economic planning has assumed significance in the light of the conditions of economy prevailing in most of the countries now-a-days. The responsibility of formulating and excuting plans cannot be delegated to private hands. In order to take the economy towards planned direction, direct participation of the State in industrial and commercial enterprises is a must.

14.3.2 Need for a Sound Industrial Base

After independence, our Government had to take the initiative in building up the industrial base of the country's economy. The Government had to set up a number of enterprises in various fields like manufacturing, mining, banking, development finance, etc., as private enterprises were hesitant or unable to provide the necessary enterpreneurship.

14.3.3 Establishment of Socialistic Pattern of Society

The Government of India is committed to the objective of establishing a socialistic pattern of society. This committment has compelled the Government to take up industrial and commercial enterprises.

14.3.4 Checking the Growth of monopoly

Public enteprises have to be established to counteract the private monopolies and big business. Only State enterprises will be able to standup to the big industrial giants.

14.3.5 Meeting Developmental Demands

In the planning process, the Government has to create and influence certain kinds of demands which are instrumental and helpful in promoting the process of economic development. It is which this view that many enterprises were started by our Government, the products of which did not have any substantial demand at beginning but the existence of which is a necessary pre-condition for the development of the economy (e.g, Iron and Steel, fertilisers, pesticides, Heavy engineering, machine tools, chemicals, etc.).

14.3.6 Generation of Surplus for Economic Growth

Revenue through taxation alone is not adequate for the modern Governments to fulfil their economic and social commitment towards the people. Public enterprises have been regarded as an important instrument for generating surplus through their profit earnings, which in turn can be plughed back in the form of investment for the purposes of economic development.

14.3.7 Need To Serve As Model Employer

The Government is interested in promoting the welfare of labour. Exploitation, job uncertainty and deplorable working conditions are to be replaced by fair wages, security of service and improved working conditions in enterprises. The State aims at serving as model employer through public enterprises in order to ensure proper terms and conditions of work for the workers.

14.3.8 Privision Of Infrastructural Facilities

There are certain areas which are extremely important to industrialization and economic growth. Most of the State investment takes place in such enterprises as are helpful to the promoting of private enterprises too. The development of the railway net-work, the road net-work, telephones and telegraph net-work, generation and supply of electricity, production of fertilizers, pesticides, construction of river valley projects, canals, dams, setting up of term lending institutions etc., are examples in this regard.

14.3.9 Greater Economy And Coordination

There is greater harmony and coordination among various industries which are brought under State ownership and control. The economies of unified control and large scale operation can well be reaped by the units in the Public Sector.

14.3.10 Balanced Regional Development

Public enterprises can be used as an instrument for narrowing the disparties in the economic development of various regions. The dicision regarding the location of new units will be taken by the Government on the basis of not only economic considerations but also social considerations. Every part of the country can thus be enabled to share the fruits of industrial development. The benefits of industrial development will not be confined to a few areas where industry is concentrated under private enterprise.

14.3.11 Equitable Distribution Of National Income

Government's participation in large scale industrial and commercial enterprises will increase the national income which goes into the common pool and is available for redistribution and reinvestment. This helps in achieving equitable distribution of national income and in reducing the economic disparties.

14.3.12 Promotion Of Pubic Welfare

Private enterprise is profit-oriented and hence private investment will be made mostly in industries yielding high profits irrespective of their usefulness to the society. On the other hand, industries which offer a low rate of return may be neglected by them whatever be their social importance. Public enterprises are, therefore, essential to ensure that the society is not denied certain basic necessities of life because of private enterpreneurs' finding them unprofitable.

14.4 OBJECTIVES OF PUBLIC ENTERPRISES

Though the points discussed under the heading, 'rationale', can well be the objectives of public enterprises, the following points need to be stressed.

14.4.1 Stimulate Economic Growth

The primary motive for the Government involvement in business is to speed up the tempo of economic development. The Government has entered various sectors of economic activity such as machine building, electricity generation, road and rail network, communication net work., fertililizers, pesticides, chemicals, etc., for the purpose of accelerating the pace of economic growth.

14.4.2 Provide Employment Opportunities

The States now-a-days assume the role of a Welfare State. One of the objectives of a Welfare State is to create employment opportunities. This objective is more pronounced in developing countries like India with abundant labour supply than in developed countries. In these developed countires public enterprises are started for the purpose of creating employment opportunities.

14.4.3 Channalled Public Savings

Economic development depends on the extent of savings and capital formation in the country. Savings and capital formation should not only be promoted but should also be channelled into priority productive avenues. The Government undertakes this by nationalising financial institutions like banks and insurance companies and by setting up a number of term lending institutions.

14.4.4 Diffusion of Economic Power

In a capitalist economy charecterised by private enterprises the emergence and growth of private monopolies is a national process. One of the several ways of tackling such monopolies is to establish enterprises in the Public Sector. Besides areas which are earmarked exclusively for the Public Sector, there are certain others in which public enterprises are set up as a countervailing force to offer stiff competition to the private enterprises and thereby check their growth into monopolies.

14.4.5 Egalitarian Society

One of the important objectives of public enterprises is to reduce disparties in the distribution of income and wealth in the country and thereby promote an egalitarian social order. This also involves checking the concentration of wealth and industries in certain areas through the application of the principle of balanced regional development.

14.4.6 Promoting Public Interst

The main objective of public enterprises is to promote the interests of the public and common good by contributing to the economic growth with social justice and by providing quality products and services at reasonable prices.

14.4.7 Strengthen Research And Developmet

Technological inventions and innovations are necessary for ensuring the quality of economic development. This involves a huge investment of funds and retention of the scientific and technological talent. Public enterprises alone can afford both.

14.5 Characteristic Features of Public Enterprises

Public enterprises have the following characteristic features :

14.5.1 State Ownership

Public enterprises are owned by either the Central Government or the State Government, either wholly or partly. In case of part ownership the State ownershipshould at least be 51% of the total amount of paid up capital.

14.5.2 State Control

State not only owns the public enterprises but also manages them. The control is exercised through the appointment of key personnel such as Chairman, Managing Director, Directors, etc., and the issuing of directions on policy matters as well as on specific issues, besides requiring the enterprises to submit returns and reports.

14.5.3 Service Motive

Public enterprises are generally run with serivice motive. Though in modern times profit earning by public enterprises is justified their primary objective is always to render serivice to the public at large.

14.5.4 Government Financing

The financial needs of public enterprises are generally met by the Government through appropriation from the budget. But when individual enterprises attain maturity, they may not receive funds from the Government. The method of financing enterprises varies according to the type of organisation marking the enterprise.

14.5.5 Public Accountability

Public enterprises are accountable to the Parliament or the State legislature, as the case may be, for their performance. This is so because they are established by the Government which has to ensure their porper working. Public Accountability is ensured through a number of ways such as questions and debates in the legislative bodies, reports and committees of enquiry.

14.5.6 Planning

Public enterprises are more amenable to control, planning and integrated development of industry in the wider interest of the nation than the private ones.

14.5.7 Unlimited scope for expansion

As the resources at the disposal of the Government are unlimited, the scope for expansion of the individual enterprises and the public sector as a whole is vast.

14.5.8 Centralised Management

The reponsibility for management is, in genral, vested in a Board of management constituted by the Government. The members of the Board are not elected but are nominated by the Government.

Check Your progress-2

Name the objectives of public enterprises.

14.6 SUMMING UP

The Public Enterprises emerged when there is no private capital to invest in the development of industrial sector and the Government is compelled to develop the resources to invest the public enterprises. Though the Government is the owner of these public enterprises, the private share holders are allowed up to 49% of the total paid up capital. These public enterprises aim at utilisation of available resources to achieve certain social ends for the rapid development and equitable distribution.

Generally the PES (Public Enterprises) are meant for planned development, checking the growth of monopoly balanced regional development, equitable distribution of National Income and more over for the promotion of public welfare. The objectives of the PES are multifolded, they create employment opportunities channel, public savings, promote public interest and stimulate economic growth. The PES have the state ownership and control financed by Governments, they have public accountability, centralised management and service motive. The role of public sector in the economic development of the country is enormous. The social welfare promoted by the PES speaks of their significance to society.

14.7 CHECK YOUR PROGRESS : MODEL ANSWERS

1. "Public enterprise is an undertaking owned and managed by the Government of a country to serve the interests of its people".
2. a) Stimulate Economic Growth b) Provide employment Opportunities c) channalise Public Savings d) Diffusion of Economic power, e) Egalitarian society f) Promoting Public

interets g) Stengthen Research and Development

14.8 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. What are the objectives of Public Enterprises?
2. Explain the characteristic features of Public enterprises
3. Examine the rationale of Pubic Enterprises.

B. SHORT QUESTONS

4. Mention different ways of justifying the setting up of Pubic Enterprise.
5. Explain the social grounds for the existance of public enterprises.

14.9 RECOMMENDED BOOKS

1.	**Bhushan Y.K.**	'Fundamentals of Business organisation and Management' Sultan Chand and Sons, Delhi, 1973.
2.	**Laxminarayana P.**	Principles and practice of public Enterprise Management S. Chand & Co Ramanagar New Delhi 1100 055
3.	**Reddy P.N. and Gulshan S.S.**	'Principles Eurasia Publishing House (P) Ltd.. New Delhi, 1981.

14.10 GLOSSARY

Accountability : Answerableness to, Responsibility to.

Ancillary Industries : Industrial units manufacturing some parts or components for large scale units.

Balanced Regional Development : Uniform development of all the regions.

Bureaucratic Interference : Interference by officials of the Government in the day to day management of public enterprises.

Cost Plus Pricing : Fixing the price at a level marginally higher than the cost of production.

Development Finance : Finance for the development of enterprises.

Functional Board : Board of Directors with fulltime members who are the executive heads of the various functional areas of the enterprise like finance, marketing and personnel.

Import Parity pricing : Fixing the price of the product on par with the cost of import of the smae product.

Ministerial Control : Control of Public enterprise by the Minister.

Nationalisation : Government take-over of private enterprise.

Non-utility concern : Concern not undertaking any essential service.

Optimal Utilisation : Utilisation of the resources at the Optimum level getting maximum returns at minimum cost.

Parliamentary Committee : Committee apppointed by the parliament.

Parliamentary Control : Control of Public enterprises by the parliament.

Plough back : Investment of the surplus in the same concern.

Public Accountability : Answerable to the public about the public enterprises.

Public Enterprise : Enterprise of the Government.

Public Reporting : Reporting the performance of Public enterprises to the members of public.

UNIT-15 MANAGEMENT OF PUBLIC ENTERPRISES

Contents

15.0 AIMS AND OBJECTIVES

This unit aims at explaining the different forms of organisation of Public Enterprises (PEs) and their relative merits and demerits. It also accounts for the composition of Boards, accountability and pricing policies in Public enterprises.

At the end of this unit, you will be able to understand:

Recognise the different forms of organisation and management of PEs i) departmental; ii) public corporations and ; iii) Govt. company

- identify the types of Boards that are operated
- understand the nature of Public accountability
- explain the pricing policy followed

15.1 Introduction

In this unit, we have presented the different forms of organisation of Public enterprises and their management.

There are certain special issues in Public eneterprises, which may not arise in private enterprises. The efficiency of management of the public eneterprises depends on the decisions made on these issues. A few such issues are choice of the form of organisation, composition of boards, pricing policy and accountability.

15.2 Forms of Organisation and Management

Forms of organisation has an important bearing on the success of the enterprise. The right choice would promote good administration leading to sound management and efficient production or service. On the other hand, a wrong choice could hinder good administration resulting in uneconomic production, inefficient service and unscientific management. Various facotrs need to be weighed inselecting the form of organisation for a particular enterprise. They include the nature of the programme, operating and financial requirements, types of operation and the political climate or opinion. The main consideration should be that the normal administrative and financial procedures customary in Government departmental administration are not suitable for commercial and industrial enterprises. The mian forms of organisation of State enterprises are:

A. Government Department
B. Government Company
C. Public Corporation

15.2.1 Government Department

The oldest form of operating public enterprises is through a Government Department. Departmental administration has been widely, used and proved successful for a certain number of State enterprises. Postal services, Railways and Forestry are prominent examples. Departmental management is indispensable for such lines of activities as are to be kept secret for strategic reasons. The manufacture of arms and ammunition, production and control of atomic energy and other defence industries are managed by Government Departments. This form of administration is also desirable where the State has to asssume full responsibility. The State trading scheme under a system of rationing is the best example of this. Projects which are still at the initial stage have to be departmentally managed till they reach a stage of developement.

Features

The overall responsibility for management rests with the Minister under whose ministry, the undertaking functions and he, in turn, delegates authority downward to the various levels of the organisation. Thus the line type of authority relationship is represented between executives at different levels.

The undertaking is financed through annual budget appropriations made by Parliament or the State Legislature, as the case may be, and its revenues are paid into the treasury.

Its personnel are civil servants and their recruitment and service conditions are the same as for other civil servants.

For purpose of budgeting, accounting and auditing, the undertaking is treated on par with other Government departments.

It enjoys the sovereign immunity of the State and therefore cannot be used without the consent of the Government.

Merits

The accountability of the enterprises to Parliament is complete, as its management is under a Ministry.

It lends itself to the maximum degree of Government control.

It can be used as an instrument to implement the Government's economic and social objectives.

There is no risk of its funds being misused or misdirected, as it is subject to strict financial control.

It helps the Government to earn maximum revenue. It also helps the Government to maintain service to the society at the minimum possible cost.

Demerits

This form of organisation suffers from the serious drawback of excessive cantralisation of administration. It lacks the freedom and flexibility necessary for efficient business operations.

There is too much re tapism and delay. Precious time is wasted by sending up and down notes and files.

Quick decisions cannot be taken by officers even on urgent matters, as they have to consult their superiors.

Administation is likely to be inefficient, corrupt and uneconimic.

As it is run on the same lines as the other Government departments, the business principles necessary for its success are overlooked.

Its personnel, being civil servants, lack business orientation and training. They also fail to avail themselves of the expertise professional management.

It becomds subject to political changes and attacks motivated by political considerations. Frequent interference in its day-to-day management by politicians has become the order of the day.

Too many Parliamentary committees investigating the functioning of such enterprises frequently hamper the proper functionning and growth of these enterprises.

9. There is very littel scope for initiative and innovativeness, as everything is subject to

Since it is the creation of a specific law, the law can be tailor-made to meet the specific needs of a situation.

Drawbacks

The corporation finds it difficult to affect changes in its consitution as it is only the Parliament or the State Legislature which is competent to bring about changes.

Though there is autonomy of the corporation in theroy, in actual paratice there is ministerial interference in its day-to-day finctioning through the Chariman-cum-Managing Director.

Representation of various interests in the Board of Directors may have divergent views which will hamper the smooth running of the organisation.

The public accountability of the corporation acts as a stumbling block in the operational effieiency of the enterprise.

Inspite of these drawbacks, Public Corporation offers the best form of organisation for public enterprise as it combines public interest and operational autonomy.

Check Your progress -1

Name the different froms of public enterprise organisations

15.3 Types of Boards

Government Companies and public corporation are managed by Governing Boards or Boards of Directors appointed by the Government. The Board of a public entreprise should act only in the interest of the people. While it is the master of the enterprise, it is the servant of the public. Depending upon the composition and functions of the Boards, there are three types of Boards : 1. Policy Making Board; 2. Functional Board; and 3. Mixed Board.

15.3.1 Policy Making Board

This Board is composed of part-time members only. The Executive may be the full-time Chairman or Managing Director. It lays down the operational policies to be adopted by the undertaking leaving their execution to the paid executives. This board has the advantage of independence though it suffers from the drawback that the Direcotrs lack time and attention.

15.3.2 Functional Board

This board consists of full-time members, each of them being responsible for a specific function such as purchasing of materials, production, personnel management, marketing, etc. The Railway Board is an example. But this type of board is neither possible nor desirable for every public undertaking. Its members may look at things from the point of their individual functions and thus fail to have a total and broader perspective. It is also difficult to obtain persons who are efficient enough to act as full-time directors.

15.3.3 Mixed Boards

This type consists of both part-time and full-time directors. The part-time directorships are held by outside experts and Government officials while the functional paid exeutives of the enterprises are the full-time directors. The Boards of Indian Oil Corporation and State Trading Corporation are examples. One drawback is the possible friction between the Chief Executive and the full-time directors. However, such chances may be minimised, if the proper role and importance, of the authority of the Chief Executive is appreciated and respected by the Board and the Ministry.

15.4 Public Accountability

15.4.1 Meaning

Public Accountability refers to the fact that the public enterprise is answerable to the public. This power is exercised by making the enterprise answerable to the Parliament or State Legilature as the case may be. The following instruments may be used for public accountability.

15.4.2 Ministerial Control

Ministerial control is the highest in the case of departmental undertakings. A Minister enjoys wide powers on the enterprises under his charge. He has the authority to nominate and remove directors, call for inofrmation on existing and proposed schemes, get periodical reports, issue directives, etc. Ministerial cotrol should not be allowed to interfere in the day-to-day opeations of the enterprise.

15.4.3 Parliamentary Control

As the primary objecitive of public enterprise is to render service, it is necessary that Parliament should exercise some control on their working. the Parliament has to see that : .

a. the consumers are provided with quality goods and services at reasonable prices; and

b. interests of labour are protected.

Parliamentary control is exercised through :

a. Questions in Parliament;

b. Debates on the annual demand for grants of the ministries;

c. Annual reports of Government companies under Sec. 639 of the Companies Act, 1956;

d. Review by the Public Accounts Cimmittee; and

e. Review by the Committee on Public Sector undertakings.

15.4.4 Audit of Public Enterprise

The accoutns of departmenal enterprises are audited by the Comptroller and Auditor General. The audit of Government companies and public cirporations is done by the professional auditors appointed by the Government on the advice of the Comptroller and Auditor General. The Comptroller can also conduct a supplementary independent audit, if he so desires.

15.4.5 Public Reporting

Public reporting is ensured through placing of annual reports of the public undertakings on the table of the Parliaments, reports on Parliamentary discussions and reports of various committees constituted by the Parliament. Information also comes through certain periodicals like Lok Udyog of the Bureau of Public Enterprises.

15.4.6 Autonomy VS. Accountability

Autonomy in relation to a public enterprise means operational autonomy. In other words, the management's policy-making and the execution of policies are independent of political interference. It is generally found that accountability and autonomy are two different things. If there is too much interference by teh Parliamnent, autonomy will be nuillified as evry decision of the public enterprise can be reivewed by the Parliament. Management of the enterprises will be discouraged because it cannot take any independent decision. On the other hand, autonomy given beyond a limit may frustrate the concept of accountability. Unrestricted autonomy may impede Government control and there may be negligence in the achievement of social goals because of the running of a public enterprise merely on commercial principles. Therefore, it is necessary to find a balance between accountability and autonomy.

Check your Progress-2

What is public accountability?

15.5 Pricing Policy

In India public enterprises have not developed a prescise and uniform pricing policy. This is becuase of the fact that most of the public enterprises are set up for the achievement of socio-economic objectives like the allocation of resources, regional development, generating employment, social services, etc. rather than formerely generating surplus. A system of price determination in public enterprises should serve the following three objectives :

1. It should promote the rational allocation of scarce resources.
2. It should accelerate the growth of the economy, and
3. It should lead to optimal utlisation of resources.

The following pricing policies are currently in practice among the public enterprises in India:

1. Profit making (Sindhri Fertilizers Hindusthan Machine Tools)
2. No profit-No loss basis (Hindusthan Insecticides and Hindusthan Antibiotics)
3. Pricing at a loss (Rural branch expansion Programme of State Bank of India and Regional Rural Banks)
4. Import-Parity Pricing (Hindusthan Shipyard)
5. Concessional Pricing for long-term cotracts or bulk purchases (Chittaranjan Locomotives and Hindusthan Steel Ltd.)

The Administrative Reforms Commission study team laid down the following principles for pricing in public enterprises.

1. Public enterprises must at least pay their way not run into losses unless there are clear and overriding reasons of public interest, as indicated in an open directive issued by the Government.
2. Public utilities and services should lay greater stress upon the achievements of optimum size than upon return on investment. The output should be extended to a level at which marginal cost equals price resulting in no profit-no loss pricing.
3. While determinimg the price structure commensurate with the surpluses expected from them, public enterprises should keep the level of output as near the rated capacity as possible, subject to the volume of demand for the products.
4. Discriminating or differential rate pricing may be adopted where it is observed that well-to-do people should pay more than poor ones for the same product or service.
5. Public enterprises in the industrial and manufaturing field should aimat earning sufficient surpluses to make a substantial contribution to reserach and developemt with their own earnings.

15.6 SUMMING UP

The public enterprises have come to stay with a greater scope for the economic development of the country. The public enterprises are the Government organisations meant for the social upliftment in a democratic country. These different forms have different types of public enterprises management. The type of management depends on the nature of organisations. There are three types of organisations; i) Government department; ii) Govt. Company; iii) public corporation.

i) The oldest form of public enterprise is Govt. department. eg : Postal services, railways. It enjoys more independence. There are merits and demerits in this form of organisation. ii) The Government company is one in which holds 51% share capital and the rest is held by private people. Most of these organisations are trading concerns, eg : H.C.L., ITI, etc., This company form is created under the companies Act. This company with its autonomy operates all the activities successfully. iii) Public corporation is formed with a special act eg : Indian airlines, SBI, LIC. It has separate entity for its operations. There are three types of boards. i) Policy making Board; ii) functional Board; iii) Mixed board With the help of these boards the decision will be taken by the management.

15.7 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Government Departments management
   ii) Government Company
   iii) Public Corporation
2. Public accountability refers to the fact that the public enterprise is answerable to the public. This power is exercised by making the enterprises answerable to the Parliament or State Legislature as the case may be.

15.8 MODEL EXAMINATION QUESTIONS

A. ESSAY QUESTIONS

1. Distinguish between Government Department and Public Corporation.
2. What are the considerations influencing the pricing policv of public Enterprises?
3. List out the features of statutory corporation

B. SHORT QUESTIONS

4. What is meant by Departmental organisation?
5. What is a Government Company?
6. What is statutory company?
7. What is a policy Board?
8. What is a Mixed Board?
9. What is meat by Public Accountability?
10. What is meant by Public Reporting?

15.9 RECOMMENDED BOOKS

1. **Bhushan Y.K.**	'Fundamentals of Business organisation and Management' Sultan Chand and Sons, Delhi, 1972
2. **Krishnaswami O.R.**	'Essentials of Commerce' Eagle Press Publications Division, Madras, 1981.
3. **Reddy P.N. and Gulshan S.S**	'Principles of Business Organisation and Management', EurasiaPublishingHouse (P) Ltd., New Delhi, 1981.
4. **Singh D.P. and Chabra T.N.**	'Fundamentals of Business Organisation' Kitab Mahal, Allahabad. 1981.

15.10 GLOSSARY

Budgest appropriations	:	Allocation of funds for public enterprises by the Government through budget.
Centralised Management	:	Decision making powers concentrated at the top management
Centralisation of Administration	:	Concentration of decision making powers at the top management
Developmental Demand	:	Demand for certain type of goods which will accelerate the industrial development
Diffusion of economic power	:	Decentralisation of the productive resources of the country
Government Company	:	Company registered under the Indian Companies Act in which the Government holds at least 5% of the share capital

Government Department	:	Department of the Government, Central or State.
Integrated Development	:	Development in all respects
Line Authority	:	A type of superior-subordinate relationship in which the authority moves vertically
Mixed Board	:	Board of directors consisting of both full-time and part time members.
Operational Autonomy	:	Independence in operations
Operational Efficiency	:	Efficiency in operations
Optimum size	:	The size of the unit giving maximum return at minimum cost
Policy Board	:	Board of directors with part time members only
Professional Management	:	Management by experts in management either with a qualification in management or having long experience in management
Professional Manager	:	Person having management as his profession. He may have either a degree in management or long years of experience in managing large concerns
Red-tapism	:	Undue delay in decision making

UNIT-16 : PUBLIC UTILITIES

Contents

16.0 AIMS AND OBJEFTIVES

This unit gives an analysis of public utilities and it covers the features of public utilities, the problems faced by publications and examines the management of public utilities once you go through this unit. you will be able to :

- understand the meaning of public utlities
- list out the characteristic features of public utlities
- indentify the special problems faced by the publicc utlities,
- explain the nature of social control, over public utlities.

16.1 INTRODUCTION

The previous unit was devoted to the analysis of public enterprises and their different forms of management. This unit gives us the discription of public utilities. Which are more essential for the common man. Depending on the nature of services rendered the corporation is named after public utilities and they enjoy the monopoly power to the extent possible.

16.2 Meaning of Public Utilies

The institutions which undertake certain essential services like the supply of gas, water, electricity, Urban transport, etc, are called public utilities. The development of urban areas and rise in the standard of people's living have necessitated such basic services. The undertakings which are engaged in these indispensable services are to serve the public. The public utility undertakings are organisations established basically to arrange the efficient and uninterrupted supply of the goods that are absolutely indispensable for a civilised community.

Public utilities are allotted a definite market area within which they enjoy monopoly. This type of monopoly is permitted legally because this will avioid duplication of expenditure on equipments, materials, and payments to staff. As these organisations deal with necessities of life, Government imposes several restrictions on quality, price, quantities supplied and the method of supply. This will regulate the supply of adequate and better quality goods and services at a lower price. In order to compensate for the loss of revenue due to the regulations imposed certain privileges are extended to public utilities. They are the powr of Franchise, authority to fix reasonable price and assured market without another competitor in their area of operation. In order to prevent the public utilities from exploiting consumers through monopoly, several restrictions are imposed. The public utility companies have the obligations to serve all the people fully, without any discrimination and charge a reasonable price for their goods and services.

Check youe progress - 1

What is public utility concern?

16.3 Characteristic Features of Pubic Utilies

Public utilities have some specials features. They are:

16.3.1. Supply of essential commodities and services

The public utilities supply the baisc needs of the general public. Such goods and services are very much essential for the day-to day life of people. Hence uninterrupted supply of these must be made by the public utility concerns. Generally such commodities will be required by the urban population. Electricity, gas and water are a few examples.

16.3.2 Inelastic demand

The products supplied by public utilities are essentials of daily life. Hence the demand for such commodities is inelastic. Even if the prices of the commodities or services of public utilities increase, the demand for them will not decline. The goods and services of public utilities may be used :

a) for immediate consumption and (b) for further production

The degree of inelasticity of demand varies according to the nature of demand. Goods or services with direct demand have high degree of in elasticity while those with indirect demand have low degree of inelasticity. The reason for the low degree in the latter case is that any increase in the price of goods with indirect demand may prompt the consummers t go for substitutes.

16.3.3 Non-transferability of demand

The demand for the product or service of the public utility concerns cannot be transferred to anybody else. This is because such product or service is required by individual consumers. The demand is individualistic. For example, gas, and electricity are needed by every consumer. He cannot transfer the demand to anybody else nor will he be able to postpone the use of these items.

16.3.4 Monopoly Power

The public utilities enjoy monopoly. In public utility concerns, the direct competition is not desirable in the interest of the economy in production and distribution. The monopoly is attained by public utilities because of some natural limitation. For example, a particular source of water in a municipal area may be under the control of the municipality as it involves expenditure in installing the plant and distribution channel and the area for consumption is limited. Duplication of such plants is a waste. In order to avoid such uneconomic and wasteful expenditure monopoly is given to public utilities.

Though there is no direct competition for public utitities, indirectly there may be substitutes. For instance a generator owned by an individual is a substitute for electricity, but the supply of the substitutes is meagre and spare.

16.3.5 Huge Investment in Fixed Capital

Most of the public utilites distribute the commodities to the consumers at their houses.

They have to make heavy investments for production-plants and machine and also for distribution channels like piplelines, posts, wires, and other equipment. For Gas, Railways, City Transport, Electricity etc, investment in fixed capital is very high. The maintenance changes, repair charges, and replacement costs are also very high in public utilities. The product and service of most of the public utilities cannot be stored and the demand may be uneven among the consumers. For example, city transport has to be maintained throughout the day,, through the traffic is heavy only during peak hours and the number of buses to be operated is based on peak hour traffic and hence the requiremnt of fixed capital will be very high . The number of staff required to operate this equipment will also be more and therefore the working capital requirements are also high.

16.3.6 Powr of Franchise

Even before the commencement of the business, the central or State Government will give special powers to these public utilities in order to function effectively and efficiently. These powers provide some special rights and privileges to the concern. These powers help them to make use of public property to lay roads and Railway lines, pipe lines and install electricity posts in a specific area allotted to the concern. These powers may be given for a specific short period or for a long period. Only with the help of this Franchise Power, they are permitted to enjoy monopoly within their area of supply.

16.3.7 Public Control and Regulation

The public utility undertakings enjoy monopoly. Since the articles they supply are essential to life they have chances of exploiting the consumer. So Government takes suitable measures to control and regulate their business. Regulations may be imposed on quality of service, price, and use of Franchise power. Only by proper control the Consumers can be assured of good quality goods at reasonable prices and the public life and property can be safeguarded.

The franchise like laying polls, pipes, etc., can be exercised without causing much inconvenience to the public. The supply of products and services is subject to strict regulation. The public utility concerns must ensure adequate and safe supply to the consumers. It must charge reasonable price only. The cost plus pricing is followed. For any revision of prices, approval of the Government is required. Thus public utility concerns are subject to the control of public authorities like Government or Semi-Government bodies, for example the Municipalities.

16.3.8 Low Risk

The degree of risk in public utilities is lower when compared with other enterprises. As the public utilities supply basic needs and also enjoy monopoly they do not have business risk.

Special Problems of Public Utilities

The public utilities have some peculiar problems regarding the size of the business, choice of site, distribution and pricing.

16.4.1 Size

The public utilities supply the basic needs to the consumers. They are expected to serve and satisfy the consumers fully in the specific area allotted to them. As they enjoy monopoly and Franchise power,the demand for the commodity will be more and so a large scale production is to be carried on. Therefore public utilities are very large in size. In the case of public utilities, even before the commencement of supply, all the plants and the distribution equipments must be installed. Hence heavy capital outlay is involved.

16.4.2 Site

Though the public utility concerns invest huge amounts they cannot select the site or place of distribution as they like. They have very limited choice in the selection of the place of business. The municipality or corporation or such other local body will decide the place of site and area of distribution. The distribution has to be arranged as per the conditions of the local bodies.

16.4.3 Sales

The public utilities have to supply the product at the doors of the buyers. Hence these concerns must arrange appliances so as to supply the product and services at the premises of the consumers. Some of the products of public utilities are non-storable in nature and hence they are to be distributed continuously. The products of public utilities are standardised, are meant for meeting the basic needs of people and as they enjoy monopoly, they need not spend money for advertisement and sales promotion. The public utilities follow the system of cash sales only. Hence they have no problem of bad debts. Most of such concerns sell their goods directly to the consumers avoiding middlemen and there by keep to the reasonable price.

16.4.4 Pricing

The public utilities while fixing the price of the goods have to consider promotional and social aspects. In order tomake the public buy more and more they will have to charge the lowest possible price. This type of fixing lowest price will also satisfy the regulations of the Government. Large-scale production helps in reducing the cost per unit.

Price discrimination is also followed. Generally high price is charged in inelastic market segment and also low price in the elastic segment. For example the Electricity Board charges different rates for different categories of consumption such as domestic consumption, industrial consmption, and agricultural consumption. The public utilities are legally permitted to follow full-cost pricing. Therefore there is no chance for incurring any loss by such cencerns.

16.4.5 Social Consideration

The public utlities supply essentials of life which are needed alike both by the rich and the poor. As service organisations, they have to charge a higher price for the rich, and a low price of the poor. This enables even the poor to make use of the services of public utilities.

Check your progress-2

What is social consideration in public utilities ?

16.5 Social Control, Owership and Management

16.5.1 Social Control

Public utilities supply basic needs of daily life and enjoy monopoly power. Hence they are subject to regulation and control by public authorities. Such regulations are essential for enforcing regular and continuous supply of better quality and pure products, so that health hazards and public inconvenience can be minimised. If the public utilities are not regulated properly they may result in water pollution, improper maintenance of machines and equipment leading to irregular supply, etc. In order to eliminate such drawbacks there is always the need to have effective social control over these organisations. Besides, with the help of their power of monopoly they may be tempted to charge high prices and earn super profits. This could be prevented only by effective public control over them.

In order to ensure such effective control over public utilities, most of the public utilities are run either by Government or by semi Government bodies like corporations or municipalities or by public bodies.

16.5.2 Owernship and Management

Though it is suggested that by proper regulations and controls, the public utilities can be regulated; it is not possible to achieve cent percent success. Mere regulations will be ineffective and so public welfare cannot be promoted. Though it is believed that private management will be more effective than Government and semi-Government, they will not promote public interest. Hence it is necessary to bring the public utilities under public ownership. Even on social and ethical grounds it is essential to bring these organisations under public ownership. If owernship is left in the hands of private parties they may supply electricity or gas only to thickly populated areas, or provide trasport facilities to thickly populated areas and neglect other areas where the users are fewer in number. So such areas will be completely neglected by private owners because of uneconomic marketing in such areas. If they are under public ownsership they do not mind such losses and extend their services to all. Hence public ownership is most desirable for public utilities.

Public ownership can be in anyone of the following forms : 1. Government department, 2. Municipal Committee 3. Public corporation.

Government Department

A public utility, may be run by a separate department of government, for example, Post and Telegraphs Department, and Railways. It may be a central Government department or a State Government department. It will come under the control of a separate Minister. Though Government officials take up the responsibility of running the department, the Minister is answerable to the Parliament or Assembly.

The merits of this type of organisation are :

1. There is public accountability.
2. There is no financial problem as the Government sanctions funds through budget allocation. The revenue will also go to the exchequer.
3. The consuming public can easily get their grievances redressed through their representatives in the Assembly or Parliament.

The demerits of this system are :

1. The administration suffers from bureaucracy, redtapism and corruption.
2. The local conditions are not given due importance.
3. The consumers have to accept the services whatever be their quality and nature.

2. Municipal Committee

The public utilities operating in towns can be managed by the concerned municipality or corporation. The minicipality or corporation will appoint a committee or sub-committee to look after the activities of the concern. A municipality is managed by the representatives of the people elected in the area and understands local problems and aims at satisfying the needs of the people. People's representatives. being local, have direct control over the organisation. This is an advantage over the other types of organisation. The local problems can be understood and settled by local representatives quickly. If there are any profits from their operation they can be used for public welfare in the same municipal area. As the permanent officials are answerable to the elected representatives, the administration will be comparatively better.

The shortcomings are as follows :

The local representatives may not be experts in management. The political wrangles prevailing in a town will always affect the regular and smooth functioning of the organisation. The area of operation used to be limited and hence optimum size of the concern cannot be maintained and large scale advantages will not accrue. So most of such units will be uneconomical. Due to the above reasons several of the public utilities run by municipalities are functioning ineffectively.

3. Public Corporation :

A public corporation will be established by passing a special Act in the Assembly or Parliament. It will function as an autonomous body with its own rules and regulations, powers and functions as prescribed in the concerned Act. This organisation will function without interference by Government. It will be managed by a Board or committee where the Government nominates members.

The corporation is accountable to the Parliament or Assembly as the case may be The share capital is contributed by the Government, financial institutions and corporations. Hence it functions like a public limited company. This organisation combines the effeciency and flexibility of private organisations and financial control and regulations of Government. Hence among all the organisation public corporation has been considered the most suitable form of organisation for public utility undertakings.

16.6 SUMMING UP

Public Enterprise and Public utilities go together in achieving the goals of social obligations. The public utilities undertake certain essentail services like the supply of gas, water, electricity, urban transport etc. This public utilities aim at serving the public for better consumer satisfaction in whatever activity they are performing. They are allotted a definite market area within which they enjoy monopoly.

The public utilities undertake the supply of essential services and has inelastic demand for their goods, huge capital is invested and there is public control and regulation. Inspite of the varied flexibility and advantages of this public utilities, they face some problems like size of the organisation, area of operation, sales, pricing and finally the social consideration. The public utilities are managed by Govt. and hence there is automatic the Govt., they are established in the from of Govt. department, Municipal committee or corporation. Among these three types of organisations, the Public corporations are the most suitable for public utility services.

16.7 CHECK YOUR PROGRESS : MODEL ANSWERS

1. The institutions which undertake certain essential services like the supply of gas, water, electricity, Urban trasport, etc., are called public utilities.
2. The public utilities supply essentials of life which are needed alike both by the rich and the poor. As service organisations, they have to charge a higher price for the rich, and a low price for poor. This enables even the poor to make use of the services of public utilities.

16.8 MODEL EXAMINATION QUESTIONS

A. EASSY QUESTIONS

1. Explain the characteristic features of Public utilities.
2. Describe the special problems of Public utilities.
3. Expalin the forms of organisation adopted for public utilities.

B. SHORT QUESTIONS

4. What is a public utility concern ?
5. What are the social considerations in public utilities ?
6. What is meant by social control of public utility ?
7. Mention the three types of organisation of public utilities.

16.9 RECOMMENDED BOOKS

1. **Bhushan Y.K.** — 'Fundamentals of Business organisation and Management' Sultan Chand and Sons, Delhi, 1973.
2. **Krishnaswami O.R.** — 'Essentials of Commerce' Eagle Press Publications Division, Madras, 1981.
3. **Reddy P.N. and Gulshan S.S** — 'Principles of Business Organisation and Management' Eurasia Publishing House (P) Ltd., New Delhi, 1981.
4. **Singh B.P. and Chabra T.N.** — 'Fundamentals of Business Organisation' Kitab Mahal, Allahabad, 1981.

16.10 GLOSSARY

Egalitarian Distribution of National Income. : Justice in the distribution of national Income

Financial control : Control over finances

Financial Autonomy : Freedom in raising and using finance

Financeial Independence : Freedom in raising and using finance

Infrastructural facilities : The basic facilities necessary for the development of industries such as trasport and electricity.

Model Employer : Employer who is a model to other employers.

Monopoly power	: Power to fix and change prices at will and to regulate the supply so as to get the maximum possible price.
Municipal Committee	: Committee appointed by Municipality or Corporation, as the case may be, to manage any public utility concern.
Price Discrimination	: Charging different prices for different buyers or for different uses of the same product.
Power of Franchise	: Special privileges to the Public utility concerns.
Public censure	: Criticism by the general public.
Public Control	: Control by the Government.
Public control and Regulation	: Control and regulation of public utility concerns by the Government.
Public Ownership	: Ownership of public utility concern by the Government
Public Utility concern	: Concern undertaking certan essential serivce.
Socialistic pattern of society	: Development of the Economy aiming at equitable distribution of income and wealth.
State Ownership	: Government Ownership
Statutory Corporation	: Corporation brought into existence by a special legislation
Term Lending Institution	: Financial institution making long term loans.
Welfare State	: Government having the objective of promoting social welfare.

BLOCK-IV BUSINESS FINANCE AND MARKETING

UNIT-17 FINANCE PLANNING

Contents

17.0 AIMS AND OBJECTIVES

This unit aims at introducing Finance Planning in Business Finance. At the end of this unit, you will be able to :
- understand the meaning of finance and finance planning - explain the concepts of capital and their effect on the business.

17.1 INTRODUCTION

Finance is a very important component of any economic activity. In the first part of this unit, the need for finance, finance planning and the estimation of capital requirement are described. And in the latter part the concepts relating to capital i.e. Capitalisation, Over Capitalisation, Under Capitalisation, fixed and working capital are explained.

17.2 Need for Finance

Finance is the life-blood of business. No business can be managed without finance. In a monetized economy, exchanges take place through the medium of money. Therefore, finance represents purchasing power and it is required in running an enterprise for acquiring all other inputs like plant, machinery, tools, raw materials and services of human beings, etc.,

Today, division of labour, specialisation and mechanisation are extensively used in industry and commerce. With a view to deriving economies of large-scale operations through these devices, business tends to be carried on a large-scale. The need for finance has, thus, increased enormously. Thanks to economic development, there is vast expansion in business, and hence the growing demand for finance.

Further, modern production and distribution are 'round about' process, involving time gap between purchase/production and consumption. Finance is required to bridge this time gap and keep the business going on.

Finance is required for various purposes. These purposes include :

1. acquiring fixed assets like plant, machinery, land and building, tools, furniture, etc., required for a business.
2. purchase of raw materials and components.
3. meeting production expenses like wages, cost of power etc.
4. meeting administrative expenses like salary, rent, carriage, office expenses,
5. meeting financial charges like interest on loan
6. meeting selling and distribution expenses like advertisement, selling expenses, etc.
7. meeting maintenance expenses like repairs and replacements.
8. meeting research and development costs.
9. expansion and modernisation.

Where from does finance come for business ? Financial (captial) formation takes place out of savings. Savings presuppose thrift and economy. Individuals and institutions may invest their savings in their own business or in the securities of corporate bodies which run business or in financial institutions which finance industry and commerce.

17.3 Finance Planning

The management of finance calls for proper planning. Finance planning means making decisions on financial requirement. raising of required finance, and judicious allocation of finance to various uses.

Finance planning involves the following important aspects :

1. estimating the total amount of capital required initially.
2. estimating the additional amount of capital required at various stages of expansion of the business unit and its modernisation.
3. determining the division of the total capital into block capital and working capital.
4. determining the sources from which capital is raised and their relative proportions, and
5. formulating capital administration policies/procedures.

17.4 Estimation of capital requirements

The amount of capital required is worked out by estimating the following cost items : 1. Promotion expenses which include incorporation fee, lawyers' fees and other preliminary expenses. 2. The amount of block or fixed capital required for acquiring fixed assets such as land, buildings, machinery, tools and equipment. 3. The amount of working capital required for financing current business operations. 4. The cost of getting the business well established. This includes operating losses in the initial stages of production.

These costs are estimated with reference to the scale of operation proposed, time gap involved between production and marketing, seasonal fluctuations in the demand for the products and the frequency of circulation of working capital. An analysis of the statistics of similar undertakings will provide necessary guidelines for estimating the cost on above items. The estimate should be realistic. An underestimation may result in inadequacy of capital which will affect operations and led to financial difficulties. Over-estimation will result in underutilisation of capital with the corresponding reduction in the rate of returns. Therefore, estimation should be made very carefully.

17.5 Concepts relating to total capital

These concepts include :

-capital
-capitalisation
-capitalstructure

Capital refers to the total wealth or total assets or total investments of an undertaking in current assets, tangible assets like land and building, plant and machinery, etc., and intagible assets like goodwill.

Net capital means net worth i.e., excess of total assets over total liabilities.

Capitalisation means the total accounting value of all the capital regularly employed in a business. It is represented by the face value of shares and debentures and reserves. It includes owned capital (i.e., share capital and reserves) and long-term borrowed capital.

While 'capital' refers to the total wealth represented by share capital, reserves, long-term debts and current liabilities, capitalisation includes only share capital, reserves and long-term debts.

Capital Structure means the financial structure or make-up or composition of the capitalisation of an undertaking. It refers to the kinds of securities constituting the capitalisation. This concept is discussed in detail in Unit 18.

Check yours progess - 1

What is meant by capitalisation ?

17.6 Capitalisation

There are two bases for capitalising new companies, viz.,

1. Cost theory or approach
2. Earnings theory or approach

17.6.1 Cost Theory or Approach

According to this approach, the value of an undertaking or capitalisation is arrived at by adding up

-the cost of fixed assets

-working capital

-cost of establishing business, and

-other costs

This provides a better basis for capitalisation in the case of a new company. This calculation enables the promoters to know the amount of capital to be raised. However, this is only a static figure representing the value of investments made in the undertaking, but it does reflect the true value of the enterprise, judged from its earning capacity. If, for example, some fixed assets remain idle or become obsolete (out dated) or poorly employed, the earning will decline leading to a fall in the true value of the enterprise, even though the value of investments made in it remain the same.

17.6.2 Earning theory or approach

This approach recognises the earnings of an enterprise. An enterprise is a profit-making entity and its value depends upon its earning capacity. Therefore, the value or capitalisation of an undetaking, is equal to the capitalised value of its estimated average earnings. The normal rate of return on capital in other companies in the same industry is 15%. If the comapany's estimated average prfit is Rs.60,000 the capitalisation of the comapny is 60,000 X 100/15 Rs.4,00,000

The merit of this approach is that capitalising is directly related to the earning capacity of an enterprise. It reflects its true value. But a new company may find it difficult to make a reliable estimate of its expected earnings or in the initial years its rate of return may not be comparable to the normal rate of return in the industry. Hence this approach may not be suitable to new companies.

Actual and proper capitalisation

The total of the face value of shares, debentures and retained earnings of an enterprise may be called its actual capitalisation e.g., the balance sheet of a company includes the following long-term liabilities :

	Rs.
paid-up capital : 10,000 equity shares of Rs. 10 each	1,00,000
5,000 9% preference shares of Rs.10 each	50,000
5,000 12% debentures of Rs.100. each	5,00,000
Reserves	50,000
	7,00,000

The actual capitalisation of this company is Rs.7,00,000

The proper or normal capitalisation of a company can be computed by capitalising its average annual profits at the normal rate of return of similar companies in the same line of business. Suppose, a company's average annual profit is Rs.65,000 and the normal rate of retunr in the industry is 10%, the proper capitalisation will be 65,000 X 100/10 Rs.6,50.000. A comparison between the actual and the normal capitalisation will show whether fhe comapny is properly capitalised, over-capitalised or under capitalised.

17.7 Over-capitalisation

17.7.1 Meaning

If the actual capitalisation of an undertakng exceeds its normal capitalisation, it is said be over-capitalised. In other words, an undertaking is said to be over-capitalised, when its earnings are not adequate to yield a fair return on the capital employed. Over-capitalisation may also arise when the book value of shares, bonds/long-term debts and retained earnings exceeds the current value of assets. Over-capitalisation does not mean excess capital. It only means that the capital is not effectively utilised with the result that the earnings are sub-normal. The main sign of over-capitalisation is a fall in the rate of returns over a long period. It is a chronic condition and not a condition prevailing in a particular year. Only when an undertaking has consistently been unable to earn the prevailing normal rate of return on its securities, it is said to be over-capitalised.

Check your pregress-2

What is Over-Capitalisation ?

17.7.2 Causes for over-capitalisation

1. over-estimation of earnings for capitalising
2. capitalising the estimated earnings at a very high rate
3. over-issue of shares and debentures than the enterprise can profitably use
4. Abnormal promotion expenses
5. Over-valuation of assets taken over from the promoters or others. This leads to watered capital. 'Water' is said to be present in the capital, when a part of the capital is not represented by assets.
6. Acquisition of fixed assets in a period of high inflation
7. Inadequate provision for depreciation and replacement
8. declining price level and the consequent fall in profitability.

17.7.3 Effects or consequences of over-capitalisation

The effects include :

1. **Reduction in the rate of dividend on the equity shares**
2. **Fall in the market value of the shares**
3. **Losing the confidence of the investors and the consequent difficulty in raising additional funds for improvement or expansion.**
4. **Inefficiency in maintaining the quality of the products.**
5. **Difficulty in selling products at fair price.**
6. **Inability to compensate the employees at prevailing rates.**
7. **Inability to compete with other concerns.**

8. going into liquidation and the consequent loss to the shareholders and creditors.

17.7.4 Remedies

Can over-capitalisation be remedied ? It can be remedied by adopting the following drastic measures with the consent of shareholders and creditors :

1. Reduction of par value of shares
2. Reduction of the number of equity shares
3. Reduction of interests on debentures and preference shares
4. Squeezing the water out of capital by bringing down the book value of assets to the level of their real value.

All the above measures involve re-organisation

17.8 Under-capitalisation

17.8.1 Meaning

This is just the reverse of over-capitalisation. An undertaking is under-capitalised when its actual capitalisation is lower than its proper capitalisation. In other words, a company is said to be under-capitalised when its rate of profit on the total capital is consistently higher than the normal rate of return in the industry, or when its real value of assets exceeds their book value.

17.8.2 Causes

The causes for under-capitalisation are :

1. Under-estimation of earnings.
2. Capitalising earnings at a very low rate
3. Buying assets at a depression period
4. Under valuation of assets for which shares are issued.
5. Appreciation in the value of assets
6. Over-provision for depreciation
7. Favourable market for the products
8. Rise in the general price level.

An under-capitalised financial position is sound; it offers higher rates of divident ; the market value of its shares will be higher than the par value. Nevertheless, under-capitalisation like over-capitalisation is undesirable, because it gives rise to certain undesirable developments.

For eg.,

-higher dividend rates attract new entrants in the field
-competition is encouraged and made acute
-higher dividend rates prompt employees to ask for higher remuneration
-consumers may feel that they are being exploited by the company
-the management may be tempted to manipulate share values
-it may attract government control and higher taxation.

17.8.3 remedies

It is desirable to remedy under-capitalisation. The possible remedies are :

1. Declaration of bonus, if surplus is available
2. Writing up the value of assets to create surplus and declare bonus shares.
3. Splitting-up of shares reduce the rate of dividend per share
4. Increasing the par value of shares

Both over-capitalisation and under-capitalisation are dangerous, and so both are undesirable. However over-capitalisation is more dangerous than under-capitalisation, as it has adverse consequences on the company, the shareholders and the society.

17.9 Division of the total capital

The total capital is divided into fixed capital and working capital. These require special consideration, as the success of any business largely depends on the effective management of the fixed and working capital.

17.9.1 Fixed (or Black) capital

Meaning

Fixed capital is the capital invested in fixed assets like land, building, plant, machinery, furniture and fixtures, which are acquired for use and not for sale. They are intended for permanent use in the business. They wear out in course of time. They serve for a certain period of time. When they become useless, they must be replace by new assets. Hence financial provision must be made for their eventual replacement when they are discarded. The fixed capital of a going concern is permanently sunk in the business. It is not available for immediate conversion into cash.

Determinants

The amount of fixed capital required depends on the nature of the industry and the size of the business unit. Heavy industries like iron and steel industry, aircraft industry, automobile industry or machine manufacturing industry need huge amounts of fixed capital. Similarly, haevy transport industries like railways tramways need large amounts of fixed capital. In short, manufacturing and extracting industries require large amount of fixed capital. But the black capital required by mere trading concerns is comparatively negligible.

Again, industrial concerns which are amenable for gradual expansion may not require large amounts of block capital at the initial stage. They may be started as small concerns and gradually expanded. For instance, textile mills can be set up with a small number of spindles or looms, which can be increased as business expands. But there are certaian industries such as water supply and, electricity works which must be set up as full-fledged concerns at the very beginning itself. They are not amenable to gradation. Hence they require huge amounts of fixed capital initially.

Sources of fixed capital

As a rule, fixed capital must be supplied by the owners of the concern. In a proprietory concern, the sole proprietor contributes capital in agreed proportions; and in corporate bodies capital is raised by offering shares for subscription. Additional fixed capital required when the business is expanded may be rasied by borrowing long-term loans. Accumulated reserves may also be utilised for financing expansion programme.

17.9.2 Working (or circulating) capital

Meaning

Working or circulating capital is the capital required for the day-to-day working of the business. It is required for the purchase of raw materials and for the payment of manufacturing, administrative, maintenance and distribution expenses. It consists of cash and other liquid assets such as stock-in-trade, book debts and bills receivable. In the course of business, workin capital changes from one form of asset to another. It changes from cash into raw materials, fro raw materials to finished goods, from finished goods to book debts, and from book debts to cash. Thus it goes on rotating or circulating, changing its form from stage to stage. In the balance sheet, it means excess of currnet assets over current liabilites. Generally, a large portion of current assets is in forms other than cash but cash alone can be invariably used to meet current liabilities. Moreover, if too great a proportion of current assets have to be converted into cash for the purpose of meeting pressing claims of creditors, the business cannot be smoothly carried on. Therfore, a 'safe' margin between current assets and current laibilities should be maintained. What is a 'safe' margin depends on the circumstance of each business. Broadly speaking, the current assets should be at least double the current liabilities.

Working capital has gained importance mainly because of the modern productive methods. Now-a-days, production is carried on in anticipation of demand and it is round about. So there is a fairly long time-lag between initiation of production and the ultimate realisation of the sale-proceeds of finished products. Hence large amounts of capital is required to keep the wheels of production on the move.

Proportion of Working Capital and Block Capital

The amount of Working capital required and its proportion to the fixed capital depends on a number of factors, such as the nature of the undertaking, the degree of mechanization and automatisation, the size of unit, the length of the manufacturing process, the rapidity of tunrnover, trade terms and the nature of the market. In public utilities like railways, tramways, gas and water works working capital bears only a small proportion to the total capital. The iron and steel, mining, metallurgical and heavy engineering industries require a higher proportion of fixed capital on account of higher degree of machanisation. Similarly, the highly capitalilised industries such as glass, chemicals, cement and paper require a very high (60% to 75%) proportion of the fixed capital. On the other hand, industries like cotton, textiles, sugar and soap require a lower proportion of fixed capital. In trading concerns, the amount of working capital required is greater than that of the fixed capital.

Determinants of Working Capital

The amount of working capital required depends upon the pattern of cash inflows and cash outflows and the nature and the extent of gap between inflows and outflows. These, in turn, depend upon the following factors:

1. The nature of the business : Public utilities such as railways, electricity undertakings etc:, sell services and do not maintain big inventories. Therefore they require a small amount of working capital. But trading, manufacturing and Financial undertakings maintain large amounts of current assets. Hence they require a larger amount of working capital.

The proportion of current assets to total assets measures the relative requirements of working capital of various industries.

2. Production cycle : This refers to the time-span between the procurement of raw materials and the completion of the production process. Funds are tied up during the process of production. Threfore longer the process of production, the larger will be the amount of working capital required.

3. Seasonality of production or sale : Industries which produce seasonally (e.g., sugar industry) and industries which sell seasonally (e.g., manufacturers of electrical goods, fans, air coolers, and woollen goods) require larger working cpaital than industries with regular production and sales.

4. Rapidity of turnover: Undertaking which sell their products quickly such as newspaper companies and bakeries require lesser amount of working capital. On the other hand, industries with slow turnover (jewellery, capital goods industries, etc.,) require larger working captial.

5. Terms of Purchases and Sales : Undertaking which procure materials on credit and sell finished goods on cash require less working capital than undertakings which buy materials for cash and sell products on credit.

6. Availability of raw materials : If the materials are readily available and the lead time (i.e., time span between the date of order and the date of receipt of goods) is low, funds will not be tied up in inventories. Hence a smaller working capital may be required. On the other hand, if important materials are not available, larger working capital is required to procure and stock them when available.

7. Requirements of cash : Companies which require heavy amounts of cash for payment of taxes and dividends naturally need more working capital.

8. Profitability : Undertaking with regular and increasing products require less amount of working capital.

Initial and regular working capital

Working capital consists of two main parts, viz., initial working capital and regular working capital.

Initial working capital : Initial working capital is the capital required for current expenditure during the development period of the industry. The development period is the period from the starting of the industry to the period when it reaches the stage at which current receipts exceed curent expenditure. This period varies from industry to industry. It is longer in plantation and mining industries than in ordinary manufacturing industries. For instance the development period of a tea industry is 5-7 years, while that of a cotton mill is 1-2 years.

Regular working capital : This is the normal working capital required after the enterprise has been established itself as a going concern. It is the amount required "to maintain a circulation of the working (i.e., current) assets from the forms of cash into inventories, then into receivables and finally back into cash."

Regular working capital consists of two parts : a fixed part and a variable part. The former refers to the irreducible minimum amount of working capital required to carry on the normal operations, e.g., the amount of office rent and establishment charges. The variable part refers to the additional amount required during busy seasons or emergencies. For instance, electricity concerns dealing busy seasons or emergencies. For instance, electricity concerns dealing in refrigerators and fans are busy during summer. Emergency may arise due to sudenrise in the price of raw materials, strikes or fire accidents.

Source of Working capital

Initial working capital and the fixed part of the regular working capital must be provided by the business itself. It is not wise to depend on outsiders for them. The additional amount required during the busy seasons may be raised by means of loans from commercial banks. Emergency requirements must be met out of own reserves, advances during difficult circumstance. There should be adequate working capital. Shortage of working capital is a great handicap to business. It would make it difficult to met current expenses. It would also prevent the concern from taking advantage of cash discounts. If delay is caused in meeting bills consequent on the shortage of funds, the concern's credit and reputation would be impaired. Thus shortage of working capital would eventually lead to disaster.

17.10 SUMMING UP

Finance is the essential requirement for acquiring all the inputs for running a business. The modern outlook and improvement in technical know-how has increased the need for finance. The finance planning is also a very important tool in the management of finance. A careful attention is paid towards the estimation and classification of capital requirements. The over capitalisation and under-capitalisation are also viewed and their relative merits and demerits are discussed. Finally the capital that is to be invested in fixed and working capital is also discussed.

17.11 Check Your Progress : Model Answers.

1. It is represented by the face value of shares, debentures and reserves
2. The book value of shares, bonds/long term debts and retained earnings exceeds the current value of assets.

17.12 MODEL EXAMINATION QUESTIONS

A) ESSAY QUESTIONS :

1. Explain the Cost Theory Approach to Capitalisation.
2. What are the causes and effects of Over-Capitalisation?
3. Both Over-capitalisation and Under-capitalisation dangerous. Discuss.
4. What are the determinants of working Capital?

B) SHORT QUESTIONS :

5. What is finance planning?
6. What is meant by block capital?
7. What is meant by capitalisation?
8. Define over-capitalisation.
9. Wahat is meant by capital structure?
10. What is meant by working capital?
11. What is the difference between initial working capital and regular working capital?

17.12 RECOMMENDED BOOKS

1. Agarwal R.D. : Organisation and Management Tata Mc Graw-Hill Publishing Co.Ltd., New Delhi: 1982

2. Bhushan Y.K.	:	Fundamentals of Business Organisation and Management. Sultan Chand & Sons, New Delhi : 1978
3. Chakrabarty S.K. and others	:	Financial Management and Control, Macmillan India Ltd., Delhi: 1981.
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6. Pandy I.M.	:	Financial Management, Vikas Publishing (P) Ltd., New Delhi :1981.
7. Reddy P.N. and Gulshan S.S.	:	Principles of Business organisation and Management Eurasia Publishing House (P) Ltd.,New Delhi 1981.
8. Sherlekar S.A.	:	Modern Business Organisation and Management Himalaya Publishing House, Bombay :1982.

17.14 GLOSSARY

Block Capital	:	Capital invested in fixed assets
Cash Flow	:	Cash receipt and cash payment
Control	:	The right to make policy decisions and to measure the performance of the enterprise and assess the performance of top excutives.
Finance planning	:	Making decisionson financial requirements, raising required finance and allocation of finance to various uses
Ploughing back of profits	:	Retaining part of the earnings as a source of finance; a method of self-financing
Profitability	:	The rate of earnings on the capital employed

UNIT-18. METHODS OF RAISING FINANCE

Contents

18.0 Aims And Objectives

This unit aims at explainig the methods of raising finance for a business concern.

18.1-Introduction

Capital occupies a pivatal role in any business concern. Capital is needed for initial promotional expenses, fixed capital and working capital. The financial manager has to choose the sources of funds. He may advise the company to issue different types of securities and debentures so as to attain an optimal capital structure. The company borrows funds from a number of financial institutions and the public.

At the end of this unit, you will be able to
- explain various methods of raising finance.
- understand the methods of sale of corporate securities
- understand the variable operations of raising finance through

Public deposistis, financial institutions, borrowings from Bank, Trade credit and finally self-financing.

18.2 Types of Capital

One requires money to make money. Money makes the wheels of business run smoothly. Efficient production system and marketing net-work are all difficulties in the absence of an adequate and timely supply of finance. A business firm requires finance to commence its operations, to continue operations and for expansion or growth. Thus finance is considered to be an important operative function of business. The success of a business enterprise is largerly determined by the way its capital funds are raised, utilised and disbursed. In the modern money using economy, the importance of finacne has increased further due to increasing scale of operations and capital intensive techiniques of production and distribution.

Every business enterprise needs two types of capital namely longterm or fixed capital and short term or working capital. Fixed capital is required for acquring various fixed assets like land, building, machinery and furniture etc. such capital is raised from the capital market. Working capital is needed for running the business and meeting day-to-day expenses of enterprises like wages and salaries etc. Short-term capital is raised from the money market.

18.3 Source and Methods of Finance:

The chief source of finance for an individual entrepreneurship is the enterpresneur himself who supplies the required capital. In the case of partnership firm, the main sources are the various partners. Similarly, the main source in case of joint Hindu family is the family which supplies capital out of the family funds. A joint stock company requires huge amount of capital. This needs three types of funds namely, (i) long term finance (ii) medium term finance, and (iii) shot term finance. Long term finance is needed for fixed capital while short term finance is required for working capital. Medium term finance is used for modernisation, for minimum working capital for launching advertising campaign etc. The sources and methods of finance depend upon the time period for which funds are required in business. The term source of finance refers to the agencies from which funds are procured while the term 'method' implies the mode of raising finance and securities issued to tap the various sources.

18.4 - Long Term and Short Term Finance:

A company may raise long term capital from the following sources: Issue of shares and debentures; public deposits; commercial banks; special financial institutions; ploughing back of profits or self-financing and the State.

It may raise short term capital from the following sources: Commercial banks, private deposits, public deposits, ploughing back profits and issue of additional shares and debentures.

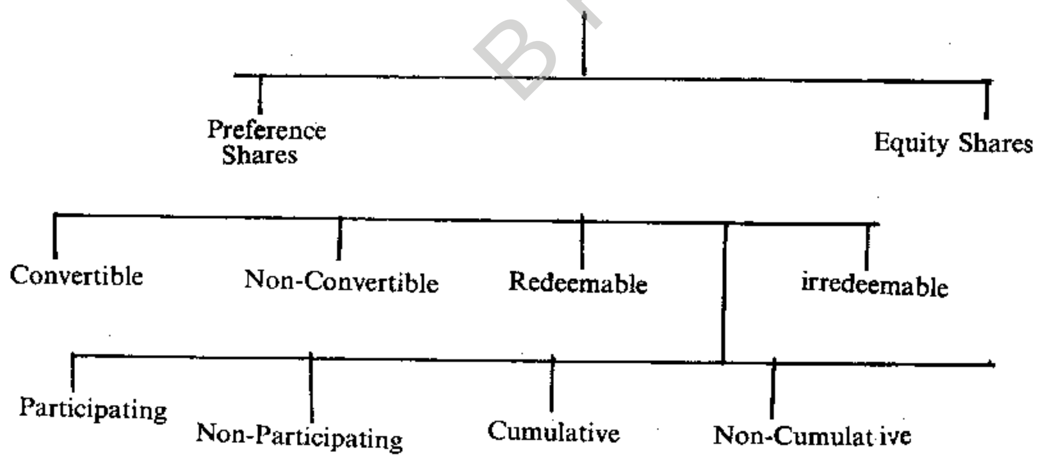
Ir may appear from the above that most of the agencies which supply the fixed as well as working capital are the same.

Long term finance is required for a period of more than ten years. Medium term finance is raised for a period of more than one year but less than ten years. Short term finance is required for less than one year.

18.5 ISSUE OF SHARES:

Issue of shares is the most popular method of raising fixed capital. The share capital of company is divided into units of equal values. Each unit respresents a part in the total capital. It is known as share and the values mentioned against it is called face value or par values. A share may thus be defined as a part of the share capital representing a shareholder's interest in the company. Under section 86 of the Companies Act, 1956 a public company limited by shares can issue two types of shares viz., Equity and Preference shares. The later enjoy preference for dividend at a fixed sale. The former rank after prefrence shares' for dividend. While preference shares are preferred by cautious investors, ordinary or Equity Shares attract adventurous investors.

CHART-7 CHART SHOWING KINDS OF SHARES



18.6 ISSUE OF DEBENTURES:

Debentures or bonds are creditorship securities representing long term indebtedness of a company. A debenture is an acknowledgement of debt by a company. A debenture has been defined as "A document under the company's seal, which provides for the payment of a principal sum and interest there on at regular intervals, which is usually secured by a fixed or floating charge on the company's property or undertaking and whcih acknowledges a loan to the company".

Debentureholders are creditors of the company. They have no voting rights but their claims rank prior to equity sharesholders and preference-shareholders. Their exact rights depend upon the nature of debentures they hold.

18.7 METHODS OF SELLING SECURITIES

There are three important methods of selling securities. They are (i) Direct sale (ii) Sale through intermediaries and (iii) Underwriting of securities.

18.7.1 Direct sale: Under this method, the company makes a direct appeal to the investors through its 'Prospectus'. The response to the public invitation depends on the public confidence in the prospects of the company and in the names of persons behind it. The prospectus is to be prepared by the financial experts giving main informations to the prospective investors about the company. The chief advantage of direct selling is that it is economical as the company saves underwriting and other commissions.

The limitations of direct sale are uncertainty of market, lack of experience of the new company in marketing the securities which bear the approval of some specialised body.

18.7.2 Sale Through Intermediaries: Under this method, the securities are sold through brokers, the company's salesman etc. Commercial Banks, Investment Trusts and others may also be employed for the purpose. The intermediaries, do not give any guarantee for the sale of the securities. They got a prescribed rate of commission for their service. This method also suffers from the same limitations as mentioned in connection with direct sale.

18.7.3 Underwriting: Under this method, the underwriters agree to sell the securities to the invsetors within a certain period of time and in the case some of them remain unsubscribed, they agree to purchase themselves. This means guaranteeing subscirptions. In case, the total amount of issue is very large,the underwriter may form a Syndicate for selling the securities. In India the commission should not exceed 5% of the issue price of shares and 2.5% in the case of debentures.

The underwriters render a variety of services to the investors and the company. They are specialists. They study the prospects of a company and decide to underwrite its issue only if they are satisfied as to its soundness. This creates confidence in the investing public and they readily subscribe to the securities offered. Thus underwriters contribute to the success of the issue by attaching the savings of individuals into corporate investment.

18.7.4 Underwriting In India : Proper underwriting facilities, as found in other countries of the world, were not available in India till recently. In India, at present; underwriting has been undertaken by stock-brokers, banks, Insuracne Companies, Investment Trusts and some Individual financiers. But lack of issue houses was a major lacuna in the structure of the capital market in India.

The Shroff Committee on Finance for the private sector in their report (1954) emphasised the need for expansion of the underwriting facility in India and recommended the establishment of a consortium of banks and insurance companies for underwriting purposes. Though this recommendation was not made, alternative arrangements were brought about for developing professional underwriting service. The Industrial Finance Corporation of India (IFC), the Industrial Credit and Investment Corporation of India (ICICI), Industrial Development Bank of India (IDBI), Life Insurance Corporation (LIC), Unit Trust of India (UTI), merchat banking divisions of commercial banks offer coordination among these institutions in undertaking underwrinting. Such expansion of underwriting facilities is timely. Company owenership has broadened. This is a healthy development. A large section of the people participate in corporate securities. The majority of investors are laymen. They are mainly small investors. Naturally they need guidence as well as protection. Again, a new class of small enterpreneurs is springing up. The level of public confidence in them is low. They need the assistance of an institution that can satisfy these two needs simultaneously i.e. an underwriting system. Underwriting institutions of repute could guide the investing public in choosing sound securities. At the same time, they could support genuine enterprises and help them in gaining the support of investors.

Check Your Progress -1 :

Define underwriting.

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18.8 Offer to existing shareholders: This method is available to an existing company only, and not to a new company. The patronage of existing sharesholders may be counted upon to a certain extent. When a company makes a furthur issue of capital, it must offer securities to existingholders on a pre-rate basis with a view to enlisting their co-operation to make the new issues success. The response to such an offer depends on the reputation of the company.

18.9 Offer to other shareholders: Companies can also offers shares for subscirption to other interested groups such as (a) employees, (b) customers, and (c) creditors. Employee shareholdership promotes co-partnership. Shareholding by customers promotes owner-user identity. Financial institutions include a convertibility clause in their long term loan agreement. They are entitled to later convert a part of their loan into equity shares. There is justification for such conversion. At the same time, this is considered as a backdoor method of nationalisation of private sector industries.

18.10 CONTROL OF CAPITAL ISSUES While raising capital through issues of shares, it has to be seen whether the provisions of the Capital Issues (control) Act, 1947 have been duly fulfiled or not and consent of the Controller of Capital Issues has been obtained, if necessary. Those responsible for issue of shares should be aware of the provisions of the said Act.

The control over the capital issues was introduced for the first time in India on May 17, 1943 under Defence of India Rule 94-A. This was done to canalise the scarce resources of the capital market in Government loans. This control lapses at the end of September 1946, but it was continued under a Speical Ordinance. In April 1967, Capital Issues (Continuance of Control) Act was passed. It was designed "to secure a balanced investment of the country's resources in industry, agriculture and the social services, and to ensure that the available capital resources are utilised on a balanced plan of agricultural, industrial and other develpments, and to keep a balance between the manufacture of capital and consumer goods".

Finally, in 1956, the Act was made a permanent one. It is now known as the 'Capital Issues (Control) Act'. It is administered by the controller of Capital Issues in the Department of Economic Affairs, Ministry of Finance. The Act provides that no economy whether incorporated in India or abroad, shall make an issue of captial or prospectus in India without the consent of the Central Government. Companies incorporated in India cannot also make an issue of capital outsided India without the consent of the Central Government. Government is empowered to quality its consent with such conditions as it may think fit to impose. It may also revoke the consent given by it or change the conditions qulaifying the consent. The Act also prohibite persons from circulating any offer for subscription or purchase of any securtities unless consent has been given by the Central Governmetn to the issue of these securities. The Central Government is empowered to grant exemption from the provision of the Act. Small capital issues of less than Rs. 5 lakhs which have progressively been increased to Rs. 10 lakhs and Rs. 25 lakhs have been exempted from control. Further, under the Capital Issues (exemption) Orders, November 4, 1966 and February 1, 1969, the issues of securities by the following categories of companies are completely exempted from control irrespective of the values.

(i) a private comapny

(ii) a Government Company not issuing securities to the general public

(iii) a banking company or an insurance company or a provident society incorported as a company. However, these companies are required to send to the Contoller of Capital Issues, details of their capital issue each quarter, if any 365 days, their capital issues were to exceed Rs. 25 lakhs. In February 1969, the Capital Issues (Exemption) Order was passed which provided for major relaxation in the control of capital issues. Under it, the public limited companies issuing capital exceeding Rs. 25 lakhs during a period of 12 months would be required to file a statement of their capital issue proposals with the Contoller of Capital Issues at least 30 days before the date of the proposed offer of capital. Such proposal would be exempted from control if they conform to following financial criteria; (i) the debt-equity ratio does not exceed 2.1 and equity-preference ratio is kept blow 3:1 (ii) shares are to be issued at par: (iii)the rate of dividend does not exceed 9.5% and the rate of interest on debentures does not exceed 7.75% and (iv)all calls are to be got fully paid-up over a maximum period of five years.

But all bonus shares, irrespective of the amount and without taking into account the status of a company be its private or Government or Banking can be issued only after getting a consent from the Controller.

As provided in the Act, the Central Government has constituted on Advisory Committee of five non-officials. The Committee is consulted on policies related to corporate investments. It meets two or three times in a year. Issues of capital is sanctioned by taking into consideration the following facotrs (i) the capital needs of the company applying for license (ii) the amount of funds already possessed by it (iii)the terms of capital issue (iv) the amount of under-writing and brokorage charges (v)the objects of the company. Permission is refused to unsound companies and speculative enterprises. Bonus issue application is refused if the company does not have sufficient genuine reserve.

When a company is granted persmission to issue capital, a period of 24 months is allowed for the raising of the amount. The company is required to submit a statement to the Controller of Capital Issues at the end of the first 6 months, and thereafter at the end of every 3 months, showing the amount actually raised by it.

The Government amended the Capital Issues (Exemption) Order, 1969 effective from October 1, 1971 and stipulated that all issues of securities by companies registered under Section 26 of the Monoplies and Restrictive Trade Practices Act, 1969 were removed from perview of Capital Issues (Exemption) Order, 1969. Its effect would be that these companies would require the prior consent of the Controller of Capital Issues for issuing capital of any type.

Thus Control of Capital Issues has become necessary to regulate the flew of investment and to direct the available capital into desired channels. In a planned economy, this control is indispensable.

Check your progress.. 2

What is the main object of Control of Capital Issues?

18.11 INSTITUTIONAL FINANCING

The Government has set up a number of special financial institutions in the country to provide long term finance to business enterprises. These institutions or development banks have become a major source of finance for floation of new concerns as well as for the modernisation and expansion of the existing concerns. They provide finance both in the form of equity and debt. These institutions are not simple financial institutions. They provide promotional, technical and managerial services. These institutions include: The IFCI, IDBI, ICICI are well known development institutions in our country. In addition, the LIC, NIDC, NSIC etc., also help in providing finance to industry. A detailed study of the constitution and working of these institutions follows in the next unit.

18.12 RETAINED EARNINGS OR PLOUGHING BACK OF PROFITS

The ploughing back or retained earnings has become an important source of financing of the business concerns. It also known as 'internal financing' and 'Self-financing'. The undistributed or retained earnings of the concerns are used to finance their long term as well as short term needs. Retained earnings are a popular source of finance for modernisation and expansion programmes. Such earnings can also be used to redeem old debts and to meet working capital requirements. The shareholders stand to gain in the long run because of the increased prosperity of the concern. The value of shares held by them may increase if this practice is adopted by the concern. From the view point of the nation also, this is an important form of capital formation so necessary for economic prosperity of society. It is a prudent polciy that at least a portion of the profits of an undertaking should be set aside every year to build up a reserve. The reserve so created be set aside every year to build up a reserve.The reserve so created serves two purposes at a time. First, it may be utilised for meeting unexpeated losses. Secondly, it may be utilised as an additional capital. The amount so ploughed back may be permanently retained in the business by issuing bonus shares. It has emerged in recent years as one of the major sources of funds for companies.

18.13 PUBLIC DEPOSITS

Public deposit implies any money received by a non-banking company by way of deposit or loan from the public including the employees, customers and sharesholders of the company other than in the form of shares and debentures. Public concerns have been a receiving public deposits for a long time in order to meet their medium term and long-term requirements for finance. People preferred to deposit their savings with the reputed business concerns due to the higher rate of interest offered by these concerns and the lack of faith in banks. Deposits from the public have been a peculiar source of finance to Bombay and Ahmedabad textile mills, tea gardens of Bengal and Assam and in a few other industries. This system had developed mainly because of the imperfect banking organisation prevailing in India earlier. The practice of accepting deposits from the public for financing purposes was continued in full swing up to the first quarter of the present century. According to the C.B Enquiry Committee (during thirties) public deposits constituted 39 per cent of the total finance in Ahmedabad and about 11 per cent in Bombay textile mills. The period of the public deposits used to be short. It varied from 6 months to 12 months. Sometimes they used to be accepted for 5 to 7 years also. The ratio of interest payable on them varied from place to place. Under Section 58-A of the Companies (Amendment) Act 1974, the Central Government may prescribe the manner and conditions in which public deposit unless an advertisement, including a statement showing the financial position of the company, has been issued in the prescribed form. Under new rules, deposits cannot be invited initially for a period of more than 3 years. However, deposits can be renewed. The rate of interest payable on deposits must not exceed 15 per cent per annum. In order to repay the deposits maturing in a particular year, the company must deposit 10 per cent of the deposits with a scheduled bank or in specified securities. Since April 1, 1980, public sector companies have also been permitted to invite public deposits. Companies accepting public deposits must regularly file retuns giving details of such deposits.

18.14 SOURCES OF SHORT-TERM FINANCE

The main sources of short term finance are trade credit, Commercial banks, instalment credit, accounts receivable financing and customer advance.

18.14.1 Trade Credit

Trade credit is the credit extended by one business firm to another as incidental to sale or purchase of goods and services. Trade credit has been defined as "credit extended by sellers to buyers at all levels of the production and distribution process down to the retailer. It does not include consumer credit or instalment credit. It arises out of transfer of goods and is unsecured". The normal period of such credit is 15 days to 90 days. The buying firm receives supplies without paying immediately. It also indicates the seller's faith in the buyer. Trade credit is available in the ordinary course of business and no security is required for getting it. Trade credit is a simple method of raising short-term finance. No formalities are involved and the credit is readily available to reputed business firms. Trade credit is more economical than bank loans. No interest is payable on trade credits and the actual cost is the loss of cash discounts. The supplier may himself be interested in granting credit as it helps to maintain his sales during keen competition.

18.14.2 Bank Credit

Commercial banks meet the short-term requirements of the business concerns in two ways; (i) By granting advances, loans, overdraft and cash credit and (ii) by discounting bills, hundies, and other commercial papers. The concerns have to establish a 'line of credit' with the banks which means the accommodation available to a particular concern from a bank under conditions agreed upon at the time of its fixing. Business concerns find it useful to raise short-term finance from the banks as banks maintain utmost secrecy of their clients' affairs.

18.14.3 Instalment Credit

Instalment credit refers to the facility of buying machinery and equipment and other durable goods on credit. The buyer has to pay a part of the price of the asset at the time of delivery and the balance is payable in a number of instalments. The supplier charges interest on the balance due and the interest is included in the amount of instalment itself. Some suppliers provide instalment credit through banks and finance companies. A business firm may also buy fixed assets on hire purchase basis. Purchase of fixed assets on instalment and hire purchase basis enables a business firm to utilise the asset and make payments out of the earnings made from such use.

18.15 SUMMING UP

The capital required by the company is raised mainly through two sources. (i) Issue of shares or owners contribution and (ii) Issue of Debentures or borrowings. This capital has of three purposes : 1. fixed capital 2. working capital 3. capital for expansion.

The capital for the above purposes is raised through the issue of shares and debentures, long term loans and ploughing back of profits. Working capital needs are satisfied by means of equity. Bank credit and public deposits. The capital for expansion is met from owners contribution, long term loans, retained earnings etc. Above all, the control of capital issues is also mentioned to regulate the flow of investment and direct the same in to variable operations.

18.16 - Check your progress : Model Answers

1. It is nothing but the guaranteeing the subscription of the company for a certain percentage of commission.
2. If a company retains a portion of the distributable profits in the form of free reserves. It is called ploughing back of profits.

18.17 - MODEL EXAMINATION QUESTIONS

A) Essay Questions :

1. Explain the methods employed for raising fixed capital.
2. Explain the methods employed for raising working capital.
3. What methods would you follow for raising finance for a new enterprise?
4. Discuss the various methods of sale of securities.
5. What are the features of control over the issue of shares?

B) SHORT QUESTIONS :

6. What is meant by ploughing back of profits?
7. Define underwriting.
8. What is trade credit?

19.18 RECOMMENDED BOOKS

1. **Agarwal R.D.** : Orginisation and Management Tata Mc Graw-Hill Publishing Co. Ltd., New Delhi, 1982

2. **Bhushan Y.K.**	:	Fundamentals of Business Organisation and Management Sultan Chand & Sons, New Delhi, 1978
4. **Khan M.Y. and Jain P.K.**	:	Financial Management, Tata Mc Graw-Hill Publishing Co. Ltd., New Delhi, 1981.
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7. **Sherlekar S.A.**	:	Modern Business Organisation and Management Himalaya Publishing House, Bombay, 1982.

18.19 GLOSSARY

Capital Market	:	Consists of sources of long term finance for industry and government.
Public Deposits	:	Fixed deposits made by public in an undertaking
Self-financing	:	Using retained earnings for financing investment
Share	:	Share in the share capital of a company, represents the interest of a shareholder in the company.
Stake-holders	:	Interested groups who have some stake in an undertaking viz., employees, creditors, etc.,
Trade Credit	:	Facility of buying goods on credit basis
Underwriting	:	Guranteeing subscription to shares or debentures.

limited company or co-operative society in India which is engaged or proposes to engage itself (i) in the manufacture, preservation or processing of goods; or (ii) in the shipping, mining or hotel industry; or (iii) in the generation or distribution or any other form of power; (iv) assembling, repairing or packing of any article with the aid of machinery or power; (v) transport of passengers or goods (vi) maintenance, testing or servicing of machinery, vehicles, vessels (vii) development of any contiguous area of land as an industrial estate; (viii) fishing or providing shore facilities for fishing or maintenance thereof and (ix) providing technical knowldege or research and development or other services for promoting industrial growth. Public sector enterprises established as public limited companies can also receive assistance from the Corporation.

Private companies, partnership firms and proprietory concerns and enterprises engagaged in the foregoing activities are eligible for financial assistance from the Corporation.

The Corporation usually sanctions financial assistance in excess of Rs.30 laks (assistance upto Rs. 30 lakh is sanctioned by the State Financial Corporations). The maximum amount of assistance by the Corporation to one industrial concern cannot exceed Rs. 2 crores except with the approval of the Industrial Development Bank of Inida. The Corporation may sanction rupee loans for less than Rs. 30 lakh where the same are required in conjunction with other facilities such as loans in foreign currency, underwriting of shares and debentures and guarantees for deferred payments for imports of capital goods or loans in foreign currency to be raised from financial institutions outside India. The maximum period of a loan can be 25 years.

19.6.2 FINANCIAL RESOURCES

The authorised capital of the Corporation is Rs. 10 crores, divided into 20,000 shares of Rs. 5,000 each. Of this 10,000 shares of the face value of Rs. 5 crores where initially issued. Later, the amount of its capital was increased. With the appproval of Central Government, it made a further issue of share capital of Rs. 2 crores in 1962. With the establishment of the Industrial Development Bank Of India in July 1964, its paid-up capital was increased from Rs. 7 crores to Rs. 8.35 crores. The paid up capital of the corporation at present stands at Rs. 20 crores out of which the IDBI holds 50 per cent, Scheduled banks 20 per cent, Cooperative banks 8 per cent and Insurance Companies and Investment Trusts 22 per cent. The Corporation can issue bonds and debentures to the public and can invite public deposits repayable within a period of five years. The IFCI is also authorised to borrow from the Central Government, the Reserve Bank Of India and the Industrial Development Bank of India. It can raise funds through foreign credits also. On March 31, 1984 the total financial resources of the Corporation amounted to Rs. 1114.47 crores out of which Rs. 59.07 crores were in the form of reserve fund.

19.6.3 MAMAGEMENT

The Board of Directors consists of 13 members including the Chairman. Out of these members, the Chairman and two directors are appointed by the Central Government, four directors are nominated by the IDBI and two directors each are elected by the scheduled banks, insurance companies and co-operative banks. The Corporation may appoint one or more advisory committees for the purpose of assisting it in the efficient performance of its functions. The head office of the Corporation is in New Delhi. It has regional and branch offices in different parts of the country. Recently it has opened offices in Guahati, Ahmedabad, Hyderabad, Mangalore, Bhubaneswar, Kanpur and Patna.

19.6.4 WORKING OF THE CORPORATION

The IFCI sanctioned a total assistance of Rs. 1993.5 crores to industrial concerns till June 30th, 1984 all over the country. Out of the total sanctions, 90.5 per cent was in the form of rupee loans and 2.8 per cent by way of loans in foreign currency. Direct subscriptions and underwriting constituted 6.7 per cent of the total assistance. Industry-wise analysis shows that more than 65 per cent of the total assistance was sanctioned to Cotton Textille, Sugar, Jute, Cement, Engineering and Paper industries. The private corporate sector received about 45 per cent of the total assistance while 20 per cent was paid to the joint sector. Public sector units got 30 per cent whereas the co-operative sector was given by June 30th, 1982 a total sum of Rs. 221.88 crores which accounted for 14.03 per cent of the total sanctions.

The IFCI provides concessional finance to units located in notified backward areas and export-oriented concerns. About 40 per cent of the total assistance was given to projects in the notified backward areas. The Corporation has set up a Hotel Development Fund out of which concessional loans of more than Rs. 15 crores have been sanctioned to various hotel projects in the country.

19.6.5 APPRAISAL OF WORKING

Over the years IFCI's activities have progressively increased both in scope and magnitude. The Corporation floated in June 1975 a Society known as 'Risk Capital Foundation' to assist new entrepreneurs and to encourage the exploitation of indigenous technology. It also grants assistance for the rehabilitation of sick units and for the setting up of ancillary units. It is no longer a purely financial institution but provides management and technical consultancy services. In May 1972, the Corporation established a Management Development Institute to provide training to the personnel of assisted concerns and development banks in diverse areas of management. The Corporation has also created chairs in various universities to promote research in banking and finance. It gives subsidies to state level technical consultancy organisation. Thus the corporation has contributed towards the widening of the base of entrepreneurship and management in the country.

19.6.6 CRITICAL REVIEW

The Corporation has been functioning on business princiles and there have been also some lapses now and then. The following are the charges levellled against its operations.

1. Generally, a long time is taken in the processing of applications and disbursements of sanctions.
2. The Corporation has acted more as a mortgage bank than as a developed bank. It has provided mainly debts against sufficient security.
3. A major protion of the tatal assistance has gone to well established and big business concerns. This has helped the concentration of economic power in the country. The share of industrially advanced states like, Maharashtra, Gujarat, West Bengal, Tamilnadu etc. in the total assistance given has been disproportoinately heavy.
4. Basic and capital goods industries received meagre assistance and bulk of the assistance went to consumer goods industries.
5. The Corporation has failed to exercise effective supervision over the utilisation of the help given.
6. It simply gave assistance in the form of loans but did not provide equity capital.
7. The Corporation granted loans only to those industries which were earning good profits.
8. The operational efficiency of the corporation has been very low on account of high establishment costs and other expenses.

Inspite of the limitations that it is gratifying to note the IFCI has played its role competently in rendering long term financial assistance to some of our key industries. It played an active part in the promotion of the State Financial Corporation. Particularly the formation of IDBI as the apex term lending organisation has relieved it from the co-ordinating role.

Check your progress-1

Distinguish between capital and money markets.

Check your progress-2

What do you understand by development banks?

19.11 STATE FINANCE CORPORATIONS (SFCs)

The need was felt for state level financial institutions to finance the needs of non-corporate and other enterprises. On Sept 28, 1951 the Parliament passed the State Financial Corporation Act. The Act empowers the State Governments to establish financial corporations in their respective areas. 18 States in India have now their own corporations. Under this,Punjab was the first State to start S F C.

19.11.1 FUNCTIONS

The SFCs are empowered to render financial help in the following:

1. Granting loans and advances to or subscribing to the debentures of industrial concerns repayable within 20 years.
2. Guaranteeing loans raised by industrial concerns repayable within 20 years.
3. Underwriting the stocks, shares, debentures subject to their being disposed off in the market within 7 years.
4. Granting soft loans to or participating in the equity of the weaker segments of the medium and small scale sector.
5. A State Financial Corporation can finance not only public limited companies but also private limited companies partnership firms and proprietory concerns.

19.11.2. RESOURCES

Under the S F Cs Act, the State Governments were to decide the authorised capital with which the S F Cs were to be started in their respective States. However, a minimum of Rs. 50 lakhs and maximum of Rs. 5 crores was stipulated, Where the paid up capital in these cases is above Rs. 50 lakhs and is upto Rs. 2 crores public are permitted to subscribe upto a maximum of Rs. 25% of the amount. The State Government IDBI, Commercial and Co-operative Banks, Insurance Companies and Investment trust are the other subscribers to the capitals of S F C s. The S F C s are empowered to issue bonds and debentures to supplement their resources. However, the amount to be raised at any time shall not exceed five times, their respective share capital and reserves. They are entitled to borrow from R B I. and their respective State Governments. They can accept deposits from the possible also for not less than five years.

19.11.3 MANAGEMENT

The management in each case is entrusted to a Board of Directors. The number on the Board should not exceed ten. The Managing Director is appointed by the State Government in consultation with the I D B I. Representation on the Board is given to I D B I, I F C I., Commercial and Co-operative Banks and shareholders. Policy matters are decided by the State Government. The Board is guided by policy instructions given by the State Government. The Board is also assisted by working Executive Committees.

19.11.4 CO-ORDINATION

With a view to preventing overlapping and competition between SFCs and IFCs, it has been agreed that applications for loans upto Rs. 20 lakhs should be dealt with by the SFC only, and the applications for loans of higher amount by the IFC. For public limited companies and Co-operatives,the limit is Rs. 30 lakhs.

19.11.5 AREA OF OPERATION

SFCs can provide financial assistance to public and private limited companies, cooperatvie societies, partnerships and sole proprietory concerns. These concerns may be engaged or propose to be engaged in the manufacture, preservation or processing of goods, mining or hotel industry, the transport of passengers or goods by road or water, generation or distribution of electricity or any other form of power, development of any contiguous area of land as an industrial estate, maintenance, repair, testing and servicing of machinery or vehicles and vessels, assembling and packing of products, fishing, consultancy services etc. The maximum amount of financial assistance to a single concern is Rs. 30 lakhs for companies and Corporations and Rs. 15 lakhs for partnerships and sole proprietory concerns. Now SFCs have been authorised to subscribe to the equity shares of weaker, small and medium industrial concerns. They can also meet the foreign exchange requirements of such industrial units.

19.8.2 RESOURCES

The Corporation started with a capital of Rs. 10 lakhs only. Originally it was conceived that it should have a share capital of Rs. 150 crores, but it started with only a modest amount of capital. The Government may increase its financial resources from time to time. The Government may provide funds to it in two ways (i) by annual grant for the purpose of study, investigation and formulation of projects and building up of technical and managerial staff and (ii) by loans to be made as and when projects are taken up by the Corporation.

19.8.3 MANAGEMENT

The Corporation is managed by a Board of Direcotrs, nominated by the Central Government. The Directors include both officials and non-officials.

19.8.4 WORKING

The NIDC functioned as an agency of the Government for the grant of special loans to any industry which the government desired to assist. It granted loans to cotton and jute industries for their modernisation and rehabilitation. It also granted loans for the expansion of machine tools units. The NIDC set up the Technological Consultancy Bureau with a view to provide consultancy and engineering services. Since its inception, the corporation has handled a large number of assignments which have also included preparation of project reports, techno economic feasibility studies, and demand surveys. Technological Consultancy Bureau has been conducting preliminary investigations of a number of projects like precision instruments, compressors and pumps, aluminium, ball and roller bearing projects, bio-gas and bio-fertiliser plant.

19.8.5 EVALUATION

The resources available with the corporation are quite meagre. It has been able to come up to the expectations in the area outlined for it. To cope-up with the demand,the Corporation has to build up further technical service specialities and capacities. The Corporation has to make efforts in the collection of arrears of principal and interest from the industries assisted by it. Such arrears are rising and would affect the financial resources of the Corporation to a great deal.

19.9 INDUSTRIAL DEVELOPMENT BANK OF INDIA (IDBI)

The IDBI was set up on July 1, 1964 under a separate statute. It has been established to co-ordinate the acitvities of the other financial institutions including banks and to serve as an apex institution in the realm of long and medium term financing. It is expected to bridge the gap in the field of financing and promotional activities so as to promote rapid industrialisation in the country. Its establishment is, undoubtedly "a mile stone in the country's journey to the institutional provision of industrial finance on a long and medium term basis".

19.9.1 RESOURCES

The IDBI of India is a wholly owned subsidiary of the Reserve Bank of India. Its authorised capital is Rs. 50 crores. The RBI has the powers to increase it to 100 crores, with the prior approval of the Central Government. The initial paid-up capital of the IDBI was 10 crores. Recently it has been increased to Rs. 40 crores following further subscripiton of Rs. 10 crores by RBI during 1972. It started with an interest free loan of Rs. 10 crores from the Central Government which was repayable in 15 equal instalments after a period of 15 years from the date of the loan. Borrowings from the Government as at the end of June 1972 stood at Rs. 166.51 crores (excluding Rs. 26.4 crores in the Development Assistance Fund) Borrowings from RBI's Long Term, Operation Fund amounted to Rs. 92.85 crores. There was no borrowing from Government of India either in General Fund or Development Assistance Fund IDAF).

The IDBI holds 50 per cent of the shares of the Industrial Finance Corporation with effect from 1964. Thus, the IFC has become its subsidiary. This has been done with two-fold objectives (a) to effect a purely administrative change by transferring the shares of the

Corporation held by the Government and the Reserve Bank and (b) to increase the resources of the Corporation.

With effect from Sept. 1964, the Refinance Corporation has also been merged with the Industrial Development Bank of India.

19.9.2 FUNCTIONS

The main functions are :

1. Subscribing to the shares and bonds of financial institutions and guaranteeing their underwriting obligations;
2. Refinancing term loans and export credits extended by other financial institutions
3. Granting loans and advances directly to industrial concerns
4. Guaranteeing deferred payments due from and loans raised by industrial concerns.
5. Subscribing to and underwriting shares and debentures of indsutrial concerns
6. accepting, discounting and rediscounting bonafied commercial bills or promissory notes of industrial concerns including bills arising out of sale of indigenous machinery on deferred payment basis.
7. Financing turn key projects by Indians outside India and providing credit to foreigners for buying captial goods form India
8. The bank may undertake promotional activities like marketing and investment, research, technological studies etc. It provides technical and managerial assistance for the promotion, modernisation and expansion of industrial concerns. Thus the bank performs financial, promotional and co-ordination functions.

19.9.3 AREA OF OPERATION

The IDBI has been given wide powers and it enjoys full operational autonomy. The bank can provide financial assistance directly as well as through other institutions to all types of industrial concerns irrespective of their size or form of ownership. There are no maximum or minimum units on the amount of assistance or security. The bank has the freedom to deal with any problem relating to industrial development in general and industrial finance in particular.

19.9.4 MANAGEMENT

The IDBI was set up as a subsidiary of the RBI with a common board of directors. But in 1976, the IDBI was reorganised under the Public Financial Institutions Laws (Amendment) Act 1975. It was delinked from the RBI and placed under the Central Government. The management of the IDBI is vested in a board of directors consisting of a chairman, a Vice-Chairman and 22 members. All directors are nominated by the Central Government but representation is given to the RBI, other financial institutions and employees.

19.9.5 WORKING

The IDBI has emerged as a premier financial and developmental agency in the country. It occupies more or less the same place in the field of development banking which the Reserve Bank of India occupies in the field of commercial banking. During a period of 21 years, the bank has sanctioned a total assistance of Rs. 15,456 crores out of which Rs. 11,302 crores have been disbursed. The IDBI launched The Seed Capital Assistance Scheme with effect from Sept. 1976 to provide assistance upto Rs. 10 lakhs to those entrepreneurs who are technically qualified but do not have capital. The bank has also introduced an Overseas Credit Scheme to finance turn-key projects abroad.

There has been substatntial increase in the assistance provided to small scale industries and road transport operators. The IDBI has assisted 6,783 new entrepreneurs with a sum of Rs. 154 crores. The bank provides assistance of Rs. 3,820 crores to 3.67 lakh small scale units in addition to Rs. 40 crores provided to village artisans.

Recently, the Government has created a separate wing in the IDBI to provide finance to the small scale sector. It has set up a special cell to promote industrial development of 25 out of the 83. 'No industry Districts' in the country. Under Seed Capital assistance scheme, Rs. 30 crores have been provided in concessional finance. It has introduced an Automatic Refinance Scheme to accelerate the flow of industrial credit to small scale and tiny sectors. The bank has launched new schemes of rediscounting foreign bills. It provided export credit both during the pre-shipment and post-shipment states. These functions have now been taken over by the Import Export Bank (Exim Bank) of India.

19.9.6 APPRAISAL

The IDBI has been established to act as a central co-ordinating agency in the realm of industrial promotion, development and financing and the country has great hopes and expectation from it. This institution is free from various restrictions and handicaps. Its incomes, profit and gains are also exempt from various taxes. It has not yet felt any problem with regard to availability of resources. But in the near future as its area of operation is increasing day by day, it may need more financial resources to cope up with the increased demand for it.

It has initiated a move to bring together several financial insititutions. 'Inter-Institutional Groups' have been formed in the States of Kerala, Andhra Pradesh, Assam and Jammu & Kashmir. These groups are expected to set up jointly sponsored and financed Technical Consultancy Service Centres (TCSC) for the respective States.

Thus under IDBI's leadership, the specialised term financing institutions are poised to play a vital and dynamic role in the process of industrial development.

19.10 UNIT TRUST OF INDIA (UTI)

The Unit Trust of India was set up on 1st February, 1964 as a statutory public corporation under the UTI Act 1963. It aims to mobilise small savings by providing opportunity for safe and profitable investment habit among people. The Trust pools the savings of the community through the sale of units and invests them in various securities. The Trust seeks to ensure a diversified ownership of industry by enabling the small investor to participate in the fruits of industrialisation. It facilitates the development of a healthy capital market in the country.

19.10.1 CAPITAL

Its initial capital of Rs. 5 crores was contributed by the Reserve Bank of India, the LIC, the State Bank of India and Scheduled banks and other financial institutions. The Trust can borrow from the RBI and the term lending institutions to augment its funds

19.10.2 MANGEMENT

The management of the Trust is vested in a Board of Trustees. The Chairman of the Board and Four other trustees are appointed by the RBI. One trustee each nominated by the LIC and State Bank of India and two trustees are elected by other subscribers to the initial capital of the Trust. The RBI also appoints an Executive Trustee. There is an Executive Committee consisting of the Chairman of the Board, the Executive Trustees and two other trustees nominated by the RBI. The Committee acts under the guidance and control of the Board. The Board of Trustees is supposed to act on business principles with due regard to the interests of unit holders.

19.10.3 INVESTMENT POLICY

The Trust sells units of a face value of Rs. inmultiplesof ten. Invests the sale proceeds and the owned funds in industrial and corporate securities. It accepts underwriting and direct subscriptions. Its investment in any one company should not exceed 5 per cent of its total investment or 10 per cent of the value of securities issued by that company, whichever is less. Out of the income earned,the Trust pays dividends to its unit-holders. The Trust aims at giving an average yield of over 10 per cent.

It offers various schemes viz., (i) Original unit scheme (ii) Reinvestment plans (iii) Voluntary saving plans (iv) Children's gift plans (v) Unit linked insurance plans (vi) Capital units plans etc.

19.10.4 TAX EXEMPTION

The UTI enjoys valuable tax concessions and exemptions. As a financial intermediary, the Trust is exempt from the payment of all taxes (a) It is exempt from payment of income-tax, super taxes on income and capital gains (b) Income upto Rs. 3,000 received from the Trust is exempt from income-tax. Units have been declared trustee securiteis so that eligible trusts can also invest in units. Investment in units upto Rs. 25,000 is exempt from wealth tax.

19.10.5 WORKING

Over a period of the last 21 years, the UTI has made remarkable progress. It has proved to be a boon to the small investor, the capital market, the corporate sector and the Government of

India. Small Investor can invest his savings in units of the Trust and can expect a fair return on his investment. By June 30, 1984 it had sold units worth more than 1600 crores to more than 17 lakhs accounts all over the country. The dividend paid to unit-holders has increased from 6.1 per cent to 14 per cent and the margin between sale and repurchase prices of units has been reduced. The Trust makes special offers during July every year. It has 2300 approved agents and 3,500 registered brokers for the sale of units through-out the country.

On 30th June 1984, unitsoutstanding amounted to Rs. 1021.30 crores. During 1983-84, units worth 2571 crores were sold under the unit linked insurance plan. There has been an overwhelming response to capital units and investment under the reinvestment plan has more than doubled. Most of the applicants are salary and wage earners and majority of the applications are for 50 units or less. On 30th June, 1985 the investible funds of the Trust amounted to Rs. 2190 crores.

19.12 SUMMING UP

Many institutions are coming forward to advance financial assistance to the industrial concerns. The loaning amounts are of various types under many schemes. Largely these institutions are supplying both short term and long term finance depending on their capacity and the credit worthiness of the concerned business enterprises. There are many constraints in the loaning pattern of these organisations and yet the Government is trying to keep the constraints aside and help the enterprises. Lot of dealy is caused in disbursing the loans. Apart form this, there is no machinery to check the soundness of the industrial units applying for loan.

19.13 CHECK YOUR PROGRESS : MODEL ANSWERS

1. Money market refers to Commercial Banks dealing with short term credit. Capital market refers long term lending shares, debentures. etc.
2. Public Corporate bodies registered under the Companies Act. They raise capital by issue of shares, debentures and invest in a large number of diversified industries.

19.14 MODEL EXAMINATION QUESTIONS

A) ESSAY QUESTIONS

1. Describe the constitution and working of the IDBI.
2. Examine critically the working of the Industrial Finance Corporations in India.
3. Write a note on the objectives and functions of State Financial Corporation in India.
4. Discuss the objectives and functioning of the Industrial Credit and Investment Corportaion of India.
5. Discuss the role of the Unit Trust of India in the field of industrial finance.

B) SHORT ANSWERS

6. Distinguish between money market and capital market.
7. What do you understand by Development Banks?
8. What are investment trusts?
9. What are the main objectives of specialised institutions?
10. Explain the main objectives of the IFC?

19.15 RECOMMENDED BOOKS

1. Agarwal R.D. : Organisation and Management

Tata Mc Graw-Hill Publishing Co. Ltd., New Delhi.

2. **Bhushan Y.K.** : Fundamentals of Business Organisation an Management Sultan Chand & Sons, New Delhi, 1989

3. **Reddy P.N. and Gulshan S.S.** : Principles of Business Organisation and Mangement

4. **Sherlkar S.A.** : Modern Business Organisation and Management Himalaya Publishing House, Bombay 1982.

19.16 GLOSSARY

Finance Market : Consists of money market and capital market

Investment Trust : A company set up for investing funds in the shares and bonds of industrial undertakings

Money Market : Refers to the commercial banks and other organisations which deal in short term credit.

UNIT - 20 : MARKETING FUNCTIONS

Contents

20.0 AIMS AND OBJECTIVES

This unit aims at explaining the meaning, importance and functions of Marketing. At the end of this unit, you will be able to understand:

- the meaning of marketing
- the importance of marketing
- the functions of marketing besides marketing information.

20.1 INTRODUCTION

Marketing includes many activities which are necessary to transport product from its production place to the place of its consumption. Marketing is the important component of the trade. This unit would also illustrate the various marketing functions. It also gives a brief note on the collection of information for the marketing.

20.2 MEANING AND IMPORTANCE OF MARKETING

Marketing links producers and consumers. It occurs when people decide to satisfy needs and wants through exchange. Marketing is a set of activities that direct the flow of goods and services from producers to consumers or users in order to satisfy human needs and wants throughexchange processes.

Marketing touches all of us everyday of our lives. Our wants are innumerable. We need various goods and services to satisfy them. But each one of us cannot produce all that he needs. Various individuals and organisations produce the goods and services needed by consumers and users. Marketing directs the flow of those goods and services to the consumers or users. It has thus delivered to us a standard of living that would have been inconceivable to our ancestors. But for marketing, human beings would have remained at the primitive stage. Without marketing, production in anticipation of demand is not possible. Marketing is thus indispensable for economic development and the consequent improvement of the level of living of people.

20.3 MARKETING AND SELLING

 Most people mistakenly identify marketing with selling. No doubt selling is important.

Someone is always trying to sell Something. But the most important part of marketing is not selling. Selling simply means mere exchange of goods or service betweem two or more persons. It is "only the tip of the marketing iceberg", it is only one of several marketing functions. Marketing includes selling and several other more important functions like needs assessment, marketing research, product development, pricing and promotion. As 'Peter Drucker' puts it, "the aim of marketing is to make selling superfluous, The aim is to know and understand the customer so well that the product or service fits him and sells itself".

20.4 MARKETING FUNCTIONS

20.4.1 Introduction

Marketing involves several activities or functions starting from need identification and ending with the delivery of the goods. These are classified in different ways.

J.F. Pyle classifies marketing functions under two major heads

Concentrating Functions	**Dispersing Functions**
1. Buying or assembling	1. Selling
2. Transporting	2. Transporting
3. Storing	3. Storing
4. Grading	4. Grading
5. Financing	5. Financing
6. Risk-bearing	6. Risk bearing
	7. Dividing

Another Classification is based on the threefold marketing process viz., concentration, equalisation and dispersion. Concentration means collection of commodities for the purpose of distribution. Equalisation consists of the adjustment of supply to demand on the basis of time, quantity and quality. Dispersion means distribution of goods to the consumers or users.

Concentration	**Equalisation**	**Dispersion**
1. buying	1. storage	1. selling
2. assembling	2. grading	2. transporting
3. transporting	3. transporting	3. grading
4. financing		4. financing
5. risk-bearing		5. risk-bearing
6. storage		

Clark and Clark have classfied marketing functions in the following manner:

A. Functions of Exchange

1. selling
2. assembling or buying

B. Functions of Physical Supply

1. transportation
2. storage and warehousing

C. Facilitating Function

1. financing
2. risk bearing
3. standardisation
4. market information

This is a widely accepted classification.

20.4.2 Concentration

Concentration means bringing the goods to a single point. The need for this process arises because of the following reasons :

Scattered production in small lots : Agricultural products like cereals, oil seeds, cotton, tea, jute etc. and dairy products like milk, butter etc. are produced by innumerable small producers scattered over the various parts of a country. They have to be collected from the producers and brought together to a single point for performing other marketing services such as grading and standardization, and processing for the benefit of consumers.

Assembly of parts : The components of the manufactured products like watches, transistors, television sets, bycycles, cars, etc., may be manufactured by different undertakings because of specialization. In order to assemble the finished product, the parts have to be collected from different manufacturers at assembly lines.

Seasonal production and intermittant procurement : Agricultural products are produced in specific season, but they are needed continously by consumers. Similarly, products produced in other regions and countries have to be procured intermittantly for the sake of convenience and economy. In order to make them available regularly, conentration becomes inevitable.

This process of concentration is performed by manufacturers, Wholesalers, dealers and their agents.

20.4.3 Dispersion

Dispersion aims at producers, goods from concentration points to the consumer or users scatterd all ov the country. Goods assembled at concentration points should reach the scattered buyers. Hence, dispersion becomes necessary.

This process is performed by manufacturers, wholesalers, agents and retailers.

Check your progress - 1

What is dispersion?

20.4.4 Equalization

This is the middle process between concentration and dispersion. It is the process by means of which the supply of goods is adjusted to the demand for them. Processing of agricultural product and production of manufactured goods is done on a large scale at a few places for purposes of economy.

On the other hand, the consumers of these products are scattred in various places. They prefer to buy the products at regular intervals in small lots at places where they live.

These differences in assortments desired by producers and consumers give rise to the need for equalization. This process adjusts supply to demand on the basis of time place and quantity.

The equalization process consist of (1) sorting out, (2) assembly, (3) allocation and (4) assorting.

Sorting out : The heterogeneous supply is graded into homogeneous groups. This classification is done so as to make sorted out groups fit the wants of consumers or users. This activity is performed in respect of agricultural produce, manufactured products and services.

Assembly : Assembly is the bringing together of sorted out groups into larger lots. It is done to facilitate further processing or marketing activities of sorting, handling, transporting, selling and buying.

Assembly is done by manufacturers and middlemen as well.

Allocation : This is the third function in the equalization process. This means breaking down of a homogeneous supply into smaller quantities appropriate for various users. A whole-saler may buy products in bulk from manufacturers and distribute them to retailers in smaller lots.

Assorting : This is the final equalization function. It means bringing together of proper quantities of different types and qualities of goods and services that various users want? A retail grocery store, for example, assembles assortments preferred by customers from numerous sources.

CHECK YOUR PROGRESS - 2

What is equalisation?

20.4.5 Buying or leasing for-use

This is a function of exchange involving a number of related activities. These activities include planning assortment, selection of sources or supply, negotiations, and transfer of title or rights of use.

The buying function begins with the determination of the kinds, quality and quantity of products and services which the buyer needs. The next step is to determine the suitability of available products and services. Suitability is judged by inspection sample or description. After the buyer has determined the suitable products and services and has located their sources of supply, he negotiates the price and terms of sale or lease, delivery date and other matters.

The buying function is performed by manufacturers, wholesalers, retailers and consumers.

20.4.6 Selling or Leasing

Selling and buying compliment each other, since both activities are needed to transfer rights of use selling involves transfer of title to the buyer. Selling includes finding buyers, stimulating demand, providing information, negotiating price and other terms or sale and delivery.

Under the competitive conditions of today, personal selling advertising and sales promotion are important.

20.4.7 Transportation

Transportation is the physical means to move the goods and people from one place to another. It moves the goods from the place of production or concentration to the places of consumption. Transportation creates place utility and facilitates large-scale production and specialisation.

20.4.8 Storage

Storage preserves products and creates time utility. Production takes place at one time, but consumption at another time. This time gap is bridged by storage. It is necessary throughout the marketing process. It is necessary to meet the regular demand for goods which are produced or transported seasonally, eg., agricultural produce, minerals. For manufactured goods, storage becomes as important function wherever demand is irregular or seasonal. Storage is also necessary as a safeguard against unavoidable delay in delivery.

The storage function is performed by a large number of institutions including producers, manufactures, wholesalers, retailers, warehouses etc.

20.4.9 Standardization and grading

These are closely related activities. Standardization refers to the actual setting up of norms for classification of goods on the basis of their physical characteristics like size, shape, colour, etc. Grading means the actual classification or sorting out of goods according to established standards.

These two activities are important for both agricultural produce and manufactured goods They ensure the uniform quality of goods and services.

The Agricultural produce (Grading and Marking) Act, 1937 provides the basic legislation foı the grading of agricultural produce. The Directorate of Marketing and Inspection, Government of Indaia promotes grading of agricultural produce. A Central Agmark Laboratory and 16 Regional Quality Control Laboratories have been set up to specify, quality standards for grading. The graded produce is sold under "AGMARK".

The Indian standards Institution specifies standards for industrial products. The products manufactured as per the specified standards are marked "ISI"

CHECK YOUR PROGRESS - 3

What is grading?

20.4.10 Financing

This is one of the facilitating or auxiliary services. Finance is needed for keeping sufficient stocks in anticipation of demand and for directing the flow of goods and services from one level to another in the chain of distribution. Commercial banks, co-operative banks, indigenous banks and money lenders provide credit to the manufacturers and middlemen for holding stock and for selling goods on a credit basis. Credit facility promotes sales. Liberal credit facility also promotes exports to other countries.

20.4.11 Risk-bearing

Risks are involved at all stages in the marketing process. Risks of loss arise on account of physical deterioration, fire, theft, damage, waste, bad debt changes in fashion or style, supply process, policy etc. Therefore the marketers at different stages have to bear risks.

Some of the risks may be transferred to others. Losses from fire, flood and theft can be transferred to insurance companies. Risks due to price fluctuations can be minimised by "hedging". The development of cold storage has reduced the risks of perishability. Decisions based on careful market study and research minimise risk arising out of changes in demand. Some risks remain with the title holders as the goods pass through the channels of distribution.

20.5 COLLECTING MARKETING INFORMATION

The performance of the various marketing activities requires adequate information. Product planning requires information on consumers' needs and wants and preferences. Buying, storing, selling, financing and transporting at different stages in the channels of distribution can be performed effectively, only when adequate and reliable information about market conditions is available. The information system developed in the marketing organisations, advertisement and marketing research facilitates collection of marketing information required for making marketing decisions.

20.6 SUMMING UP

Marketing is an important component of the trade. The marketing is a process of many activities where these selling and buying activities play a very important role. This unit would also explain the difference between the marketing and selling concepts. In the process ,the marketing functions are divided into concentration, dispersal and equalisation categories. Afterwards, the difference between selling and leasing is also explained. Apart from transporting, storage, standardisation,the financing function is also discussed.

20.7 CHECK YOUR PROGRESS : MODEL ANSWERS

1. This is nothing but distributing goods from concentration points to theconsumers'or users scattered all over the country.
2. It is the process where the supply of goods is adjusted to the demand for them.
3. It is the actual classification or sorting out of goods according to established standards.

20.8 MODEL EXAMINATION QUESTIONS

A) ESSAY QUESTIONS

1. How are marketing functions classified?
2. Explain functions of exchange.
3. Describe the functions of physical supply.
4. Describe the facilitating functions of marketing.

B) SHORT QUESTIONS

5. What is marketing?
6. Define assembling.
7. What is dispersion?
8. What is equalisation?
9. Define grading.
10. What is standardisation?

20.9 RECOMMENDED BOOKS

1.	**Amarchand, D. and Vardharajan, B.,**	:	An Introduction to marketing. Vikas Publishing House P. Ltd., New Delhi : 1980
2.	**Bhushan, Y.K.**	:	Fundamental of Business Organisation and Management, Sultan Chand & Sons, New-Delhi: 1978.
3.	**Krishnaswami O.R.**	:	Essentials of Commerce, Eagle Press Publication Division, Madras: 1978.
4	Philip Kotler	:	Principles of Marketing, Prentice-Hall of India (P) Ltd., New Delhi: 1983.
5.	Philip and Ducan	:	Marketing Principles and Methods, Richards D. Irwin Illinois : 1973.
6.	**Rajan Nair N.**	:	Marketing, Part I Sultan Chand & Son, New Delhi, 1979,
7.	Sherlekar, S.A.	:	Modern Business Organisation and Management, Himalaya Publishing House. Bombay : 1982.
8.	Varshney and Bhattacharya	:	International Marketing Management, Sultan Chand & Sons. New Delhi : 1980.

20.10 GLOSSARY

Advertising	:	Any paid form of non-personal presentation and promotion of ideas, goods and services
Agmark	:	Mark representing the specified quality of a produce
Dispersion	:	Distribution of goods to users
Entrepot trade	:	Importing goods for re-exporting to another country.
Equalisation	:	Adjusting supply to demand
Financing	:	Granting credit for performing marketing activities

Grading	:	Sorting out goods into specific groups as per standards
Marketing	:	Human activity directed at satisfying needs and wants through exchange processes
Marketing Information	:	Information needed for making marketing decisions
Risk Bearing	:	Bearing the risk of loss arising out of a marketing activity
Standardisation	:	Setting norms for classifying goods based on their Characteristics
Storing	:	Preserving goods in a building

UNIT-21 CHANNELS OF DISTRIBUTION

Contents

AIMS AND OBJECTIVES

This unit aims at explaining the channels of distribution. It also points out the role of middlemen in the distribution of goods. After completing this unit, the student will be able to explain :

- the different channels of distribution
- the importance of middlemen called wholsaler and retailer.

INTRODUCTION

Once the production of the goods is completed, they are to be distributed to the needy places or persons etc. In this connection, the various channels of distribution are used here. These channels fill the gap between the producer and consumer and these are almost the agents both to the producer and customer. These channels are also called as middlemen. The wholesaler and Retailer constituted the channels in the distribution of goods. The various merits and demerits of these channels are also described in this unit.

21.2 MARKETING CHANNELS

21.2.1. INTRODUCTION

Producers and consumers are separted by place and time. To link them, short or long channels have emerged. The distribution channels are pipelines or routes through which goods and services flow from producers to consumers.

A distribution channel may be defined as a set of middlemen or intermediaries that like titles or assist in transferring titles, to specific goods or services as they move from the producer to the consumer.

21.2.2 Functions

A marketing channel performs the work of moving goods from producers to consumers. It bridges time, place and possession gaps existing between producers and consumers.

Members of a marketing channel perform a number of key functions :

1. Research : gathering of marketing information necessary for planning and facilitating exchange

2. Promotion : development and dissemination of persuasive communications to induce demand

3. Contact : locating and communicating with prospective buyers

4. Matching : shaping and fitting of the offer to the buyer's requirements. This includes product planning, manufacturing, grading, assembling and packaging.

5. Negotiation and transfer of title : reaching final agreements on prices and other terms of the offer so as to effect the transfer of ownership of possession.

6. Physical distribution : transporting and storing of the goods.

7. Financing : raising and dispersal of funds to meet the costs of the channel work.

8. Risk taking : assumption of risks connected without the distribution work.

The relative importance of these functions may vary according to the nature of the goods. For example : transportation and storage are more important and costly in the case of bulky materials such as coal, petroleum products, iron ore etc. In the case of complex products like computers, automobiles, electronic goods, the provision of information and product service becomes predominant. In the case of consumer goods, advertising and sales promotion constitute major functions. Industrial goods depend more on personal selling.

All the above functions must be performed. They cannot be eliminated. Thus the question is not whether they need to be performed, but rather who is to perform them. All functions using scarce resources require specialisation and are shiftable among channel members. They may be performed by any one or more members. The issue of who should perform the functions is one of relative efficiency and effectiveness.

21.2.3 Major distribution channels

The most common channels used for directing the flow of goods from producers to consumers are seen from the following chart :

CHART SHOWING CHANNELS OF DISTRIBUTION

Manufacturer ———————————————— Consumer

Manufacturer ———————— Retailer ———————— Consumer

Manufacturer ——— Wholesaler ———————————— Consumer

Manufacturer ——— Agent ——— Wholesaler ——— Retailer ——— Consumer

Manufacturer ———————— Wholesaler ———————— Consumer

1. Manufacturer or producer – consumer

This is the shortest channel. It may be appropriate for industrial goods like the machinery or the plant. Consumer goods are needed by numerous and scattered buyers. Hence, this channel may not be suitable for consumer goods.

2. Manufacturer-Retailer-Consumer

This channel is usually suitable when buyers are large retailers like departmental stores, chain stores, super markets or big mail-order houses. It is also suitable for products requiring speed in distrubution. Automobiles, domestic appliances, readymade garments, shoes, etc., are directly sold to retailers. However, the manufacturer has to perform the functions of a wholesaler looking after storage, financing of inventory and transportation.

3. Manufacturer-wholesaler-Retailer-Consumer

This is the most common channel used in groceries, drugs and other consumer goods.

4. Manufacturer-Agent-Wholesalers or Distributors-Retailer-Consumer

In this channel, the producer uses the services of an agent middleman such as a sales agent for the initial dispersion of goods. For example : many textile mills have sales agents for distribution. A large national distribution company like 'Voltas' also acts as a sole agent for many manufactured products.

5. Manufacturer-Wholesaler-Consumer

The wholesaler may by pass retailer where the buyers are large institutions, e.g., industrial buyers, government, hospitals, educational institutions etc.,

There are also many possible variations.

21.2.4 Channel Choice

The channel chosen should achieve ideal market exposure and meet the target customers needs and preferences. It should also achieve marketing efficiency and effectiveness.

The channel choice is influenced by the following factors.

1. Distribution policy

There are three alternative policies, viz., (1) intensive distribution, (2) selective distribution, and (3) exclusive distribution.

Intensive distribution refers to selling througn as many outlets as possible. This is usually needed for goods of frequent consumption such as stationery, note books, soaps, cigarettes etc. The aim is to sell where the people buy. The dominent factor is place utility.

Selective distribution is selling through a limited number of dealers, granting them exclusive rights to distribute the products in their respective territories. Invariably dealers may be required not to carry competing lines. This policy is preferred where large inventories have to be carried to provide adequeate service e.g., industrial machines, automobiles and dress materials.

2. Product Characteristics

The uses of a product, its frequency of purchase, perishability, weight, size, value, frequency of fashion change, aftersale service required, etc., must be considered while choosing a channel.

Perishable or fragile products require shorter channel, but durable and standardised goods may be handled by longer and diversified channels.

3. Supply Characteristics

If the number of producers is small and if they control large resources, a short channel may be used. Where producers are numerous, dispersed and command limited resources, a long and indirect channel is used.

4. Customer Characteristics

These characteristics include a number of customers, their geographical dispersion, frequency and regularity of purchase and average quantity purchased. These greatly influence channel choice. Where customers are few, geographically concentrated and making large purchases, direct sale or the shorter channel is preferable. In the opposite case, the longer channel is desirable.

5. Middlemen Characteristics

The choice of channel also depends upon the strengths and weaknesses of various types of middlemen operating in the field.

6. Channel competition

The competition between and among channel members also influences channel choice. Producers in the same industry prefer to use the same middlemen. If the competitors employ exclusive distribution, a firm may be led to the same.

7. Company characteristics

The choice of channel is also influenced by company characteristics such as its financial position, size, product mix, managerial competence, past channel experience and marketing policies. For example, a strong company with financial strength can afford to adopt a short channel, but a weak company cannot do so.

8. Other factors

The other factors which influence channel choice include (1) environmental characteristics such as economic conditions, legal system, tax system, etc., (2) social and ethical consideration, (3) Sales volume potential (4) Cost of channel usage, and (5) the long-run profitability.

21.3 IMPORTANCE OF MIDDLEMEN

Middlemen specialise in carrying out the marketing functions. They can perform them more effectively at a given cost than the manufacturer. They also relieve the manufacturer of the bother of distribution and enable him to concentrate on production.

Even producers with the required capital may find the use of middlemen profitable. A 20 percent return on production is more advantageous than a mere 5 percent return to direct marketing. The element of risk also rises. Direct selling involves heavy investments and higher fixed costs and thus, greater risks. But if middlemen are used, risks are borne by them.

The use of middlemen largely depends on their superior efficiency in achieving the goal of marketing. They, through their contacts, experience, specialisation, scale of operation and market intelligence, offer a producer more than he can achieve on his own.

21.3.1 WHOLESALER

Meaning

The wholesaler is the first link in the chain of intermediaries between the producer and the consumer. The wholesaler has been defined as a trader who purchases goods in "large" quantities from manufacturers and sells them to retailers in "smaller" quantities. His business consists also in supplying raw materials to the manufacturers. In some cases the wholesaler functions as an exporter and importer.

The wholesaler is a dealer in a specific commodity. His business is of a specialised nature. The true wholesaler never engages himself in manufacturing or retailing. He always acts merely as a link between the manufacturer and the retailer.

Functions

The wholesaler is not a mere buyer and seller. He forecasts stimulates and interprets the wishes of his customers. In the course of his business, he renders a variety of services such as standardising, grading, sorting and packing goods. He undertakes "warehousing". He buys when trade is slack and prices are low, stores them for lean times and sells when prices rise again. He thus creates time utility and helps to keep price steady. He also helps to even out pric movements. He maintains travelling salesmen or agents to contact retailers. He owns bi warehouses to store stocks. He usually sells goods for a small margin of profit. He follows th principle of small margin and quick and large turnover.

Services to the Manufacturer

The wholesaler renders certain useful services to the manufacturer. They are :

1. He places a bulk order with the manufacturer. The latter is thus relieved of the burden of collecting small orders from the retailers.
2. By making bulk purchases, the wholesaler enables the manufacturer to benefit from the economies of large scale production.
3. The wholesaler provides the manufacturer with a readymade market.
4. The wholesaler helps the manufacturer to keep his capital circulating by clearing stocks.
5. The orders placed by the wholesaler with the manufacturer convey the information relating to the trend of the public and the corresponding change in the direction of demand and thus enable him to regulate his production accordingly.
6. The wholesaler renders financial assitance to the manufacturer by making his purchases for ready cash or by accepting bills which may be easily negotiated or discounted.

Services to the Retailer

The wholesaler renders equally important services to the retailer.

1. He relieves the retailer of the trouble and expense of holding large stocks. The retailer is required to maintain a varied stock. But he cannot do so due to lack of space and want of capital. The wholesaler bridges this gap by providing him with a ready source for replenishment of his stocks.
2. By means of his holding large stocks, the wholesaler enables the retailer to obtain supplies more quickly and in convenient lots.
3. The wholesaler renders financial assitance to the retailer by allowing him credit. This facility enables him to carry on his business with less capital than would otherwise be necessary.

4. The wholesaler keeps the retailer informed of the new types of goods coming into the field, for which he can create a demand. This gives him an opportunity to expand his business.

5. The wholesaler also helps the retailer by passing on to him some of the advantages of specialisation. The retailer benefits from the trade discounts allowed by the wholesaler and also by the latter's specialised knowledge of the marketing function.

21.3.2 Retailer

Meaning

The retail trader is the last link in the chain of middlemen between the producer and the consumer. The retailer has been defined as a trading intermediary engaged in the distribution and sale of goods to the ultimate consumer. He is thus, a dealer in consumer goods. He is in direct touch with the ultimate consumer.

"The business of retailing consists in the sale to consumers of a wide variety of products which are assembled at the retailer's premises for that purpose, sufficient in variety and quantity to meet the requirements of a large number of individual households." In short, it is the business of the retailer to study the requirements of the consumers and buy according from the wholesaler and distribute to the consumer. The economic justification of his business lies in the fact that he "sells goods in a manner which is convenient to the consumer than would be the case if the same goods were marketed by the wholesaler."

Functions

The economic functions performed by the retailer are as follows :

1. Selling in small quantities : This function is the essential feature of retailing. The retailer purchases goods from the wholesaler in lots and distributes them to consumers in small quantities according to their requirements.

2. Holding stocks : The majority of consumers are not in a position to store their requirements in large quantities due to lack of funds and space. The retailer holds stocks of goods and thereby relieves consumers of this inconvenience. He maintains stocks in his premises, makes them readily available for sale to consumers and aims at satisfaying their needs.

3. Displaying goods : Different kinds of goods are produced for the purpose of satisfying man's wants. These goods have increased in number and diversity with the advancement of civilisation. The existence add availability of such goods is brought to the notice of the consumer by the retailer by the use of window dressing and display. Goods are exhibited in well designed attractive glass windows or on burrows. The consumer's attention is drawn to them and he is induced to buy them.

4. Market Research : By virtue of his direct contact with consumers, the retailer studies the mind as regards their preference for one or other assortment of goods. He learns their different tastes and ascertains their specific requirements. He influences the producer through the wholesaler to produce that assortment of goods which is preferred by consumers. And thus he caters to their needs.

5. Providing variety of choice : The retailer assembles in his shop the various products of different manufacturers. He, thus, enables the consumers to choose from a variety of items according to his preference. The consumer selects what he requires. This right of choice takes a prominent place in satisfying human wants efficiently.

6. Rendering expert advice : The retailer by the very nature of his business is a specialist and expert in the distribution of consumer's goods. He is competent t to advise his customers as regards the selection of suitable articles from a number of goods in fact; the success of his business mainly depends on the efficient performance of this service.

7. Providing credit facilities : The retailer very often sells his goods to regular customers on credit. This is of great benefit to consmers having regular fixed incomes.

8. After-sales service : The retailer renders many other miscellaneous services incidental or necessary to the use of goods sold by him, such as repair service, supply of spare parts and accessories, door delivery, etc.

9. Providing outlet for products : Besides his services to the consumer, the retailer performs a very valuable service to the producer. He provides him with an outlet for his goods. He looks after the details of distribution and relieves him of the difficulties of marketing.

21.4 TYPES OF RETAIL UNITS

21.4.1 Introduction

Retail units are of different types. They may be divided into two broad groups- the itinerant and the fixed units. Itinerant units are a sort of mobile trading organisation, while the fixed units carry on trade from definite business premises. There are small-scale as well as large scale organisaions in the fixed form of retail trade.

21.4.2 Itinerant Traders

These traders are mainly dealers in fruit vegetables, fish and glass-ware. Pedlars,hawkers, and street vendors are itinerant traders. They have no fixed premises. They may operate as regular dealers throughout the year or purely casually during a particular season. The have very little stock and their capital outlay is very limited. They provide an effective competition to the established shop keepers and there by render valuable service to consumers in keeping down prices. Besides, they render the serive of door delivery .

Check Your progress - 1

Who are itinerant traders ?

21.4.3 Small Retail Shops

These are independent retail units with a relatively small amount of turnover. The bulk of the distribution units of the modern system consists mainly of small retail units. The reason for this is obvious. It is easy to establish such a business unit. A very small capital outlay is enough. Even the front room of a residential house can be converted into a shop with a minimum expenditure on fittings and fixtures. Stock can be had from the nearest wholesaler on favourable credit terms. The services of the members of the owner's family can be used thereby reducing cost of establishment. The trader can maintain only such varieties of articles as are needed by his regular customers. He establishes a personal contact with them and secure their patronage.

A small retail unit is commonly a family concern. It deals in a limited range of articles whose quality depends on the preferences of local customers. It renders a useful service to the consumers by enabling them to get their requirements nearer their homes and at convenient times.

The advantages of small scale retailing are proximity, credit facility, personal attention, easy formation, specialisation and inexpensive and independent management.

21.4.4 Large Retail Units

The large scale fixed retail units are the natural outcome of the tendency to expand in order to gain the advantages of large scale trading. They usually develop either on "horizontal" or on "vertical" lines.

Horizontal development takes place when the trader expands his business in its original line. e.g., a shoemaker expands his business by opening branches in different localities. Thus has evolved the multiple shop or chain-store system.

Vertical Development Occurs when a concern adds different lines of activities to its original business. For example, a bookseller may open such other departments as stationery, printing and publishing. A provision store may add another class of goods and open a new department with a view to expanding its business.

Another class of large scale retail organisation is the mail order business. This is mainly carried on through the postal parcel service. Another variation is the combination of both horizontal and vertical forms of development.

Large scale retailing renders certain benefits to the consumers. Because of bulk buying, a large scale retail store is in a position to charge lower prices. The special display technique adopted by it makes buying easy. The shop is also readily recognised by its standardised equipment.

Advantages

1. A large retail concern buys in bulk. So it is able to avail of trade discounts and favourable terms. Hence it is in a position to sell goods at a lower price to its consumers.

2. A large retail concern derives certain economies of large scale operation. Specialised expert staff can be maintained. Overhead expenses are spread over a large volume of business. Advertising cost per unit of sales is very less.

3. There is a rapid turnover. So stocks flow out quickly and fresh stocks arrive often. Thus consumers are assured of the supply of fresh goods.

4. Service is good. Customers receive a fair treatment. They can choose from a wide variety of goods. Home delivery service may also be rendered.

5. Integration may take place. Similar selling units may horizontally combine or retailing may be vertically integrated with wholesale business and manufacturing Integration results in better service and economy.

6. Shopping is made attractive, pleasing and agreeable. Articles are neatly and visibly displayed. Prices are fixed and are invariably marked on the goods themselves. There is no need for clumsy bargaining.

Disadvantages

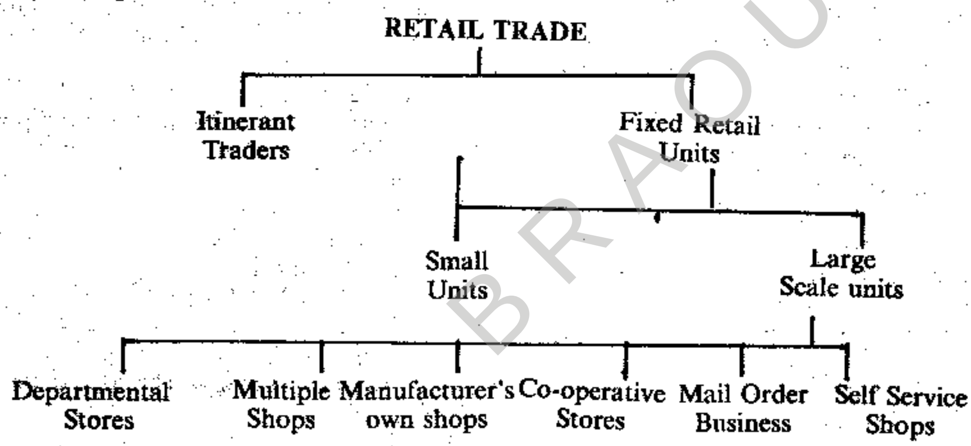
1. On account of the extra services provided, the cost of doing business becomes excessive. Increase in overhead charges may offset the economies of bulk buying. To create a large demand, it becomes necessary to spend enormously on advertisment and display. The high rent prevailing in shopping centres is another element of high cost.

2. There is no personal contact between owners and staff and between staff and customers.

3. Trade is usually on a cash basis and no credit is granted.

4. The customers are less likely to receive consideration for their personal likes and dislikes.

5. The owner has to depend on hired employees. Paid staff lack personal incentive and a friendly feeling



21.4.5 Departmental Stores

A Departmental store may be defined as a large scale retail establishment having in the same building a number of departments each dealing in one particular kind of merchandise. For instance, there may be dress-making, outfitting, tailoring, boots, hats and furnishing departments in one store. In short, it is a combination of different shops under one roof and one management. It is an outcome of the tendency to expand by diversification rather than by specification. It seeks to expand its activities by catering to a wider range of consumer requirements.

The growth of towns and cities with a dense population and the existence of cheap, quick and efficeint transport facilities have contributed to the growth of departmental stores. It is primarily an urban institution depending on the mass patronage of people for its success. Its turnover must be very large to justify its huge organisation. It attracts customers by supplying commodities of good quality and by offering services and faciliites to the customers in connection with their purchases. In fact, the success of a departmental store mainly depends on the attention to service and extreme regard for the customer's preferences. It makes extensive use of the institutional type of advertisement for the purpose of publicity. It also organises an effective window display. It pays great attention to merchandising. It selects goods which are wanted by customers.

Advantages

1. A departmental store buys in bulk which means cheaper, buying and is, therefore, able to sell at comparatively lower prices.
2. Fixed prices charged by the store and delivery at one point (the delivery department) make the shopping pleasing to the customers.
3. Stocks are large and varied, and the customer can do all his shopping under one oof.
4. Many serivices are offered. They include sale of goods on approval, free delivery, credit and shopping facilities like rest room telephone booth, restaurant, courtesy and fair treatment etc.
5. One department is an advertisement for another. An impressive arrangment makes one department advertise the next.
6. A department store acts as a leader in introducing new types of goods.

Disadvantages

1. There is no personal contact between the owners and the staff, and between the staff and the customers.
2. The extra services provided tend to increase overhead expenses. The ratio of expenses to sales is high.
3. The store is not accessible to the people residing in the residential areas which are far away.

21.4.6 Multiple shopes or Chain Stores

A multiple shop or chain store system has been difined as a "system of branch shops operated under a centralised management and dealing in similar lines of goods." It consists of a number of similar shops functioning under one ownership and scatterd over different shopping areas. It is essentially a horizontal combination of similar selling units specialising in one or two kinds of goods. Under this system, extension of the retail unit takes place by multiplication of selling points rather than by expansion of existing premises.

A multiple shop, as a rule, deals in a limited variety of articles. It specialises in a particular trade in which it has acquired specialised knowledge. Suitability of a product is an important consideration for multiple shops. The article should be one that is widely demanded so that rapid turnover may be expected in order to spread its high costs over a big turnover with a view to keeping selling price down to a minimum. The article should be stuffs, foot wear, and clothing. It should be of the standardised branded type which requires little selling effort. It should be portable so that the customer may easily carry it with him.

The multiple shop system is a combination of both centralised and decentralised principles. The principle of centralisation is applied in buying and administration and that of decentralisation in selling. Buying is centralised; the requirements of the whole system are pooled and buying is done in bulk. Bulk buying means cheap buying. This is not the only economy aimed at. Costs are further reduced by simplification of the process of retailing. Only a few lines of goods are handled. This simplifies the problems of buying and stock control. No credit is allowed. Hence capital is not locked up in book debt. Consequently, there is no bad debt and loss of interest. The selling is done by the different stores of the chain through their respective managers. The mangers are supplied with the list of selling prices and they have to effect the sales according to the rates so fixed by the centralised management

The branches are organised from the head office. Each of them is run by a branch manager. Each branch is to submit a report of its activities daily or at week ends to the head office. The accounts of the branches are then incorported into the head office accounts. Goods sent to the branches are invoiced at the retail selling price and branch managers are required to account for the value of goods sent to them as per those invoices.

Advantages

1. It enjoys the economies of buying in bulk, of centralised and efficient control, and of export, common advertising. So it sells goods at lower prices.
2. Shortage of stock at any one branch can be remedied by transfer of stock from near by branches.
3. As the "cash and carry system" is adopted, bad debts are avoided.
4. A speedy turnover is attained and the business is run at a lower cost.

5. The special display technique adopted makes buying easy.

6. It can use modern retailing practices such as maintenance of cleanliness, use of the latest equipment and illumination, etc.

7. Because of the size and large-scale operations, it can experiment with new methods in a few branches in order to determine cost and efficiency.

8. The shop aims at proximity to the customers by locating its branches in residential areas.

9. Standardisation of shop fronts makes the shop readily recognizable.

Disadvantages

1. The multiple shop system is not suitable for goods whose demand is narrow and widely fluctating.
2. The customer is less likely to receive consideration for his personal likes and dislikes.
3. The variety of goods dealt with in it is very limited.
4. No credit is allowed to the customers.
5. Personal attention is lacking and there is no personal incentive on the part of the staff to work hard.
6. Excessive standardisation is an inherent disadvantage of the chain store. It leads to inflexibility the branch manager has no freedom to use his discretion.

21.4.7 Manufacturer's Own shops

Sometimes the manufacturer himself starts his own retail chain stores for distributing his produce direct to the ultimate consumers. These stores are organised with the following objects:

1. to provide an outlet for their goods
2. to divert to himself (the manufacturer) the middlemen's profit.
3. to consolidate his hold upon a particular market.

The Bata Shoe Company and Nagpal Sewing Machine Company are the best examples. This system, of course, cannot be established by all manufacturing concerns. Only financially strong concerns can start their own stores to serve as additional channels of distribution.

These shops serve certain useful purposes to the manufacturer. He is able to study the consumer's preferences.

Its advantages are

1. Direct control of goods from plant to consumer.
2. Ability to shift stocks of goods from one branch to another.
3. Direct channel for securing knowledge of demand.
4. Elimination of middlemen's profit to a certain extent and
5. Standardisation of equipment and selling units.

Its Disadvantages are

1. Diversion of attention from the concentration of production.
2. Reflection of disturbances of productive organisation on the distributive organisation.
3. Difficulty of finding efficient branch managers and
4. Lack of expert knowledge in the distributive lines and consequent risk of losing the market.

21.4.8 Co-operative Stores

Co-operative stores are retail organisations controlled by consumers themselves. These Co-operative institutions are organised with a view to eliminating middlemen's profits. In these associations, consumers themselves become their own traders. The consumers organise themselves into a co-operative society. They contribute capital in the form of shares. The society arranges for the purchase of the articles required by its members and sells them to its members at fair prices. It aims at supplying the purest and unadulterated goods. The surplus profit, remaining after meeting the establishment expenses and after allwoing a nominal rate of dividend on the paid-up share capital of the members, is distributed among the members in proportion to the purchases made by them. Quality, correct weight and measure, fair dealing and returning the profits to the purchasers are the main advantages derived from the society. Its management is vested in a Board of Directors elected by the members.

The primary co-operative stores organise theselves into wholesale societies with a view to eliminating middlemen's profits to a further extent. The wholesale societies help to effect economies in buying. These Societies engage in manufacturing activities also. This makes them independent of the capitalistic form of manufacturing concerns. The ultimate aim behind all these arrangements is to provide the consumers with quality goods at competitive prices, thereby promoting their economic well-being.

Advantages

1. They supply pure and unadulterated goods.
2. They substitute the service motive for the profit motive.
3. They eliminate middlemen's profit and thereby promote the economic well-being of consumers
4. They encourage thrift and inculcate a sense of responsibility.
5. They train people to administer their own affairs.
6. They substitute mutual aid for rivalry and entagonism.
7. They reduce cost of distribution by elimination of the cost of advertising and equipment for ornamentation and window dressing.

Drawbacks

1. Managing committees are frequently incompetent.
2. Efficient officers are not attracted to man cooperatives as high salaries are not offered.

21.4.9 Mail Order Business

It is retailing by post. It appeals to the public on the score of convenience. The customer need not go to the retailer. He makes his shopping by post. In this business there is no personal contact between the buyer and the seller and there is no scope for personal inspection of the goods by the consumer. The mail order business firm approaches the prospective customers through advertisement and procures orders. In some cases, orders are procured through travelling salesmen. Orders are executed through post per V.P.P. For mail order business standardised branded goods and portable goods are mostly suitable e.g., watches, pens, books etc,

Check your progress-2

What is mail order business ?

Advantages

1. The customer is able to make his purchase at his home and is thus saved the trouble of going to the retailer.
2. The actual selling is reduced to the routine, the work being performed by unskilled cheap labour.
3. The business can be situated at any place, not necessarily in a shopping centre.
4. Salesmen's salaries and expensive window-dressing are eliminated.

Disadvantages

1. The customer is denied the opportunity of personally seeing and examining the goods.
2. The advetisements of mail order business often give a false idea of the quality of the goods offered and thus deceive the customer to a certain extent.
3. The expenses of advertisement tend to increase the cost for the consumer.

4. The sales appeal is stereotyped and cannot easily be modified to suit different types of

prospective customers.
5. The customer cannot receive consideration for his personal likes and dislikes.

21.4.10 Self-service Stores and Super Markets

These were developed in America in the nineteen thirties. In America, they are known as 'super markets'. The self service idea has now spread to various types of retail business. In England even cooperative stores adopt this system. The self-service idea means that the customer serves himself. He himself freely selects his requirements from the goods exhibited for sale in the shop. He is not influenced by any sales assistant. There is no bargaining. He has to pay the prices marked on the goods.

A super market proper is a big diversified store which sells everything from cleaning material to fish, meat and vegetables. All foodstuffs are neatly cut, packaged, and priced. A full range of goods is displayed on open shelves or counters. The customer goes round the various sections. He can freely inspect the stock. He selects goods of his own choice and places them in over, he takes the basket or trolley to the "check out" counter at the exit, where the bill is made out and the consumer makes the payment. In U.S.A. super markets handle more than 50% in volume of the total grocery sales.

Advantages

1. Customers enjoy the freedom of choice and purchase. They are not subject to any outside pressure. 2. Increases sales are obtained through buying on the impulses. The customer is reminded of things he required when he sees the goods displayed. 3. The cost of maintaining salesmen is eliminated. Consequently overhead charges are reduced. 4. Shopping is made every agreeable and shopping time is reduced.

Disadvantages

1. There is no personal service and advice. Naturally, in any branch of retailing where the consumers attach importance to personal service and guidance, the self service system cannot be employed. 2. As goods must be packaged before sale, packaging becomes a great problem. The retailer has to rely on the attractiveness of the packaging for his sales. 3. No credit is granted, 4. A vast space is required for an efficient display of goods and for the customers to move about freely. This means being prepared to pay a high rent.

21.5 SUMMING UP

Channles of distribution are important organs in the distribution of goods from producer to the consumer. These channels are also called middlemen. Without these middlemen, the marketing process will not be completed. These middlemen are acting as agents on behalf of producer in the distribution of goods to the consumer. These middlemen some times resort to unhealthy practice of making unwanted profit and deceive the consumer, to curb this, the competition has to be evolved among the middlemen, Apart form these two middlemen i.e., wholesaler and retailer, various retail units have come into being in the distribution of goods to the consumer. Departmental stores, multiple shops and cooperative super bazars have also contributed their mite in the process of channels of distribution.

21.6 CHECK YOUR PROGRESS : MODEL ANSWERS

1. These traders are dealers in fruits, vegetables, fish and glassware, pedlars, hawkers and street vendors are itinerant traders.
2. In this business there is personal contact between buyer and seller. It is retailing by post. It appeals to the public on the score of convenience.

21.7 MODEL EXAMINATION QUESTIONS

A) ESSAY QUESTIONS :

1. What are the factors which influence the choice of channel?
2. What are the functions of a whole saler?
3. What services are rendered by wholesalers to the retailers?
4. Explain the services of a retailer.
5. Explain briefly the different types of retail units.
6. What are the features of departmental stores? What are their merits and demerits?
7. Discuss the features, merits and demerits of chain stores.
8. Discuss the merits and demerits of a self-service store.

B) SHORT QUESTIONS :

9. Define distribution channel.
10. What is intensive distribution?
11 What is selective distribution?
12. Who are itinerant traders?
13. Define a departmental store.
14. What is a multiple shop?
15. What is mail-order business?
16. What is a super market?

21.8 RECOMMENDED BOOKS

1.	**Amarchand, D and Vardharajan, B.,**	:	**An Introduction to marketing. Vikas Publishing House P. Ltd., New Delhi 1980.**
2.	**Bhushan, Y.K.**	:	Fundamentals of Business Organisation and Management, Sultan Chand & Sons, New Delhi, 1978
3.	**Clark and Clark**	:	Principles of Marketing
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21.9 GLOSSARY

ASSEMBLING	bringing together of sorted out goods in to larger groups.
ASSORTING	assembling assortments prefereed by customers
BUYING	purchasing goods or services from their titleholder
CHAIN STORE	a system of branch shops dealing in a similar line of goods

CHANNEL OF DISTRIBUTION		a set of middlemen who transfer goods from the producer to the consumer
CONCENTRATION		bringing goods to a single point.
CO-OPERATIVE STORE		a retail unit owned and managed by consumers themselves
DEPARTMENTAL STORE		a large retail unit with several departments.
Exclusive Distribution	:	Selling through a limited number of dealers granting them exclusive rights of distribution
Marketing research	:	Systematic design, collection analysis and reporting of data and findings relevant to a specific marketing situation facing a marketer.
Middlemen	:	traders who link the producer and the consumer
Personal Selling	:	oral presentation in a conversation with prospective buyers for selling
Retailer	:	A trader who distributes goods to the ultimate consumers
Selective Distribution	:	Selling through selected efficient outlets
Super markets	:	A big diversified store selling consumers goods neatly packed and priced
Wholesaler	:	A trader who buys goods in large lots and sells them in small lots to the retailers.

UNIT-22 ORGANISED MARKETS

Contents

22.0 AIMS AND OBJECTIVES

This unit aims at explaining the meaning of organised markets. It also aims at describing the nature and funcioning of stock exchanges and produce exchanges. At the end of this unit,the student will be able to understand.

- the meaning of organised markets.
- the functioning of stock exchanges.
- the working of produce exchanges.

22.1 INTRODUCTION

The markets are essential for any goods to be marketed. The goods are marketed with less or higher prices depending on the type of markets in operation. Most of the time we hear that there are many variations both in the quality and prices of the product. This is due to the prevalance of unorganised markets. But the organised markets are there for the marketing of some special commodities and with this the market culture gives entirely a new look. The organised markets will operate under certain code of rules. Some such organised markets are stock exchanges and produce exchanges where the products have homogeneity, durability and gradability.

22.2 ORGANISED MARKETS

22.2.1 Meaning

Specialised organisation have come into existence for the marketing of certain types of commodities. They have their own functionaries, techniques and rules and regulations. These organisations are known as organised markets. These are specially constituted markets and the dealings in them are governed by specific rules and regulations and by established conventions as well. There are two major types of organised markets : 'Stock exchanges' and produce Exchanges'

28.2.2 Characteristics of Commodities suitable for an organised market

All types of commodities are not suitable for dealings in an organised market. Only commodities which possess the following characteristics are suitable for dealing in it :

1. The commodity must be homogeneous, i.e., all units of a lot must be identical in quality and must mean the same thing to different persons.

2. It must be durable so as to be suitable for 'future' dealings.
3. The commodity must be capable of being graded, weighed, measured or numbered into identical units acceptable to all.
4. Dealings in it must be extensive and be frequent justifying the participation of a large body of buyers and sellers in the market.
5. It must lend itself to organised speculative dealings, i.e., its prices must fluctuate when there is an imbalance between demand and supply.
6. The supply of the commodity must be free and open and be free from monopolistic control and government control.

Securities,shares and debentures of corporate bodies and bonds of Government satisfy all the above conditions and thus organised markets in securities have emerged. They are popularly known as "Stock Exchanges". Some agricultural produce like food grains,cotton, jute, oilseeds, tea, coffee, and mineral products like lead, copper and other non-ferrous metals are also suitable for dealings in an organised market. Accordingly, "produce or Commodity Exchanges" have been set up in the chief marketing centres of the world.

Check Your Progress - 1

What are the two types of organised markets?

22.3 STOCK EXCHANGES

22.3.1 Meaning

The stock exchange is an organised market for buying and selling securities. The securities dealt with at a stock exchange include the shares and debentures of public companies, government securities and the bonds and debentures issued by municipal bodies or port trusts.

The stock exchanges in India have been organised either as private associations or joint-stock companies. They are governed by the Sercurities Contracts (Regulation) Act of 1956. With a view to centralising the control of stock exchanges and regulating dealings in securities, the Act provides that only recognised stock exchanges deal in securities. The government has so far granted recognition to eight stock exchanges :

1) Stock Exchange, Bombay,
2) The Ahmedabad share and stock Brokers' Association, Ahmedabad,
3) The Calcutta Stock Exchange Association Limited. Calcutta,
4) The Madras Stock Exchange Limited, Madras,
5) The Delhi Stock Exchange Association Limited, Delhi,
6) The Hyderabad Stock Exchange Limited, Hyderabad,
7) The Stock Exchange at Indore, and
8) The Srock Exchange at Bangalore.

Subsequently, a few more stock exchanges were granted recognition.

The general affairs of a stock exchange are administered by an elected Committee of Management. The Committee is assisted by various sub-committees like Arbitration Committee, Defaulter Committee, Listing Committee and so on.

22.3.2 Functions

The Stock exchanges perform certain essential economic functions :

First, they provide a continuous ready market for capital which is already invested. They facilitate marketing of securities and help investors to sell their securities at any time without much loss. Thus this facility imparts liquidity to investments in corporate and public securities, and encourages people to invest their savings in them. The easy marketability of securities increase their value as the collateral security for loans.

Second, the stock exchanges provide appropriate conditions leading to a respectable open market appraisal of securities. The regular bargains and dealings facilitate market quotations which reflect the current value of securities.

Third, the stock exchanges protect the interest of investors through the strict enforcement of their rules and regulations. In the absence of organised stock exchanges, the innocent investors may easily be deceived by the clever stock brokers.

Fourth, the stock exchanges given mobility to capital. Through stock exchange operations, capital flows into the most profitable channels.

Fifth, the stock exchanges facilitate mobilisation of capital by productive enterprises. The ready market for securities provided by the stock exchanges encourages people to invest their savings in the shares and debentures of corporate enterprises and in government securities. But for stock exchanges, governments would find it difficult to float loans.

Sixth, the stock exchanges exercise a wholesome influence on the management and the working of companies in public interest. In order to get their shares included in the trading list of stock exchanges. Public companies should abide by the rules framed by the stock exchanges for this purpose.

Last, stock exchanges are sensitive to social, political and economic changes. Even a slight change in the economic policy of the government would be reflected in the dealings in the stock exchanges. Hence, as Marshall described it aptly, "Stock exchanges are not merely chief theatres of business transactions, they are also barometers which indicate the general condition of the atmosphere of business."

22.3.3 Functionaries

Only members can transcat business at a stock exchange. Only financially sound persons are admitted as members. A heavy membership fee and security deposit is prescribed. For example a member of the Bombay Stock Exchange must deposit Rs. 20,000 to buy a membership card. The members of the London Stock Exchange are divided into two classes: (a) Brokers, (b) Jobbers (i.e., independent dealers). There is no such rigid classification in the stock exchanges in india. Members of the Bombay Stock Exchange are called commission brokers and taravanials. The latter deal in securities and buy or sell securities on their own account. They can also act as commission brokers. They mainly indulge in specultive activities.

In addition to 'full' members who enjoy all the rights and previleges of doing business on the 'floor', some non-members are permitted to enter the House and transact business on behalf of the members. They are: (1) Remisiers, and (2) Authorised clerks.

Remisiers operate at the Bombay Stock Exchange only. They act as agents for members. They are paid out of the commission received by the members on the business procured by them. They are known as "half-commission men", because their commission cannot exceed 40% of the commission received on the business secured by them.

Authorised clerks are assistants employed by members. They are authorised to transact business on behalf of their employers on the floor, but they cannot make any bargain in their own name. Stock exchanges permit their members to employ a few such assistants.

Investors buy or sell securities in a stock exchange through its members. They buy securities for holding them as investments and sell them when cash is needed.

22.3.4 Listing of Securities

Only securities which are included in the official trade list of a stock exchange can be bought and sold in it. The securities of a company can be listed only when it furnishes details of its organisation and working to the stock exchange and fulfils the conditions laid down in the rules and regulations. But this should not be taken to mean that the stock exchange guarantees the financial soundness of the company. The government has framed the following statutory rules for listing of securities under the Securities Contracts (Regulation) Act 1956.

A company desiring that its securities be listed must apply in the prescribed form with the following documents and information :

(1) Copies of the Memorandum and Articles of Association, Prospectus, Directors' Reports, Balance Sheets and underwriting agreements, etc.
(2) Specimen copies of shares and debenture certificates, letters of allotment, acceptance, etc.
(3) Particulars regarding its capital structure.
(4) A statement showing the distribution of shares.
(5) Particulars of dividends and cash bonus declared during the last 10 years.
(6) Particulars of shares or debentures for dealing in which permission is applied for.

(7) A brief history of the company's activities since its incorporation.

While scrutinising the application, the stock exchange examines (a) whether the Articles of the Company contain the following provisions : (1) A common form of trasfer shall be used (2) Fully paid up shares will be free from lien. (3) Calls paid in advance may carry interest, but shall not confer a right to dividend. (4) Unclaimed dividends shall not be forfeited before the claim becomes time-barred (5) The option to call on shares shall be given only after a sanction by the general meeting. (b) Whether at least 49% of each class of securities issued was offered to the public for subscription through newspapers for not less than three days. (c) Whether the comapny is of a fair size, has a broad-based capital structure and there is a sufficient public interest in its securities.

After the scrutiny of the application, if the stock exchange authorities are satisfied, they call upon the company to execute a listing agreement.

The stock exchange then insists that all applicants for shares are treated with equal fairness regarding allottment. It tries to ensure that applicants for large blocks of shares are not given undue preference over others.

The Company whose securities are listed with a stock exchange must.

1) notify the stock exchange of the date of the meeting at which dividend will be declared.
2) Forward immediately to the stock exchange copies of its annual audited accounts after they are issued.
3) Notify the exchange of any material change in the general nature or character of the company's business,
4) notify the stock exchange of any change in the company's capital, and
5) notify the stock exchange of the issue of any new shares to the members,

Advantages of Listing : This listing of securities is advantageous to both the management and the shareholders and investors.

The advantages derived by the management are many. First it confers a distinct advertising value. Second, it enables the management to broaden and diversify shareholdigs and provide existing shareholders with a better market for the securities they hold last, the listing facilitates the widespread distribution of the company's securities and thus enables it to raise all the finance it wants.

The shareholders and investors also derive manifold benefits. First, the listing affords liquidity to their holdings. Second, it affords them to obtain the best prices for the securities which they want to sell. Third, it helps them to avoid canvassing from door to door to sell the securities. A mere telephonic oral order to a stockbroker will help him to buy or sell a listed security. Fourth, the stock exchange quotations help the investors to know the current prices of their securities. Last, the listing gives an added collateral value to the securities held by ivestors, for banks in advancing loans, prefer listed securities.

22.3.5 Speculation

Besides genuine investors, there are dealers who buy or sell securities for the sake of trading. They are called speculators. They indulge in speculation. the term 'speculation' is derived from the Latin word speculate meaning 'look ahead'. Speculation means buying or selling securities in the hope of a profit from anticipated changes in price. Speculators buy some securities with a hope to sell them in the future at a profit, or sell them with the hope to sell them in the future at a profit, or sell them with the hope of buying them at a lower price later. Thus they seek to earn profits through price differences. They are different from investors. They do not care for the safety of Investment and rate of returns. Nor do they actually buy for cash or sell for cash and take or give delivery of the securities. They buy securities without the intention of taking delivery. They try to sell them to others at a higher price before the date of settlement. Similarly they sell securities which they do possess in the anticipation of a future fall in prices, but they do not intend to give delivery.

Speculation may be a gunine venture or many degenerate into gambling.

The genuine speculation is based on a reasoned forecast on the probability of a rise or fall in the price of commodity. It performs a very vital function. It provides the requisite volume or continuity of business which alone would enable a large number of buyers and sellers to trade at all times in the exchange. Pure investment buying and selling cannot provide such a continuous business.

By discounting future price movement, speculation renders price changes gradually. Speculators buy now in anticipation of a future rise in price and so they raisecurrent prices. On the other hand, by selling now in anticipation of future low prices, they cause currentprices to fall. Thus the movement in prices is rendered more gradual and this reduces the risk that investors run in carrying large holdings.

On the other hand illegitimate speculation or gambling consists mainly of operations undertaken blindly and ignorantly by ignorant or amateur gamblers with the idea of reaping large profits. It may also be a deliberate mainpulation of the market by highly skilled operators Speculation of this kind is harmful to the community in general for investors suffer losses due to the violent price fluctuations so caused.

Types of Speculators

The speculators in a stock exchange are called by different names according to the nature of their operation. Each type is named after a beast, probably on the basis of their resemblance with the behaviour of animals.

1. Bull : A bull is a speculator who expects a rise in the price of a certain security. With this expectation, he now buys the security (without taking delivery) to sell it in future at the expected higherprice. A bull is also known as a tejiwala. Just as a bull throws his victim upward, the bull, by his operations raises the price of a security in the stock exchange.

2. Bear : A bear (also known as mandiwala in the Bombay Stock Exchange) is a speculator who expects a fall in the price of a security. With this expectation he sells for future delivery securities which he may or may not possess. At the time of settlement, he buys securities at a lower price and fulfills his original agreement to sell. In this way he earns a profit out of a fall in price. If, however the price rises, he will suffer a loss.

Just as a bear presses its victim down to the ground, the bear speculator, by his operations, pulls down the price. Hence the name 'bear'. His operation of selling a security which he does not possess is called 'short selling'. When the price falls as expected, he is said to cover his short sales by making a corresponding purchase.

3. Lame Duck : When a bear finds it difficult to meet his committment on the date of settlement, he is said to be struggling like a lame duck. A bear may agree to a certain security on a fixed date. But on that date, he may not be able to deliver the security, as it may not be available in the market.

4 Stag : A stag is one who applies for the shares of a new company in the hope of selling them later to the public at a 'premium'. A stag is more cautious, yet he is bullish, because he expects a rise in the price of the security.

The stock market is said to be 'bullish' when the bulls dominate with an expectation of rise in prices. The optimism prevails in the market. On the other hand, the market becomes bearish. When the bears dominate and there is an expectation of a fall in prices. Pessimism prevails in such a market.

Sometimes when the purchases made by the speculators exceed the sales made by them, i.e., when there is an 'over bought' condition in the market, the bulls begin to spread rumours about a rise in the prices, This is known as a bull campaign'. Similarly when the 'over sold' condition prevails, the speculators may spread rumours to bring the price down. This is known as a 'bear-raid'.

Check your progress - 2

What is meant by speculation ?

22.3.6 Trading in Stock Exchange

Anyone who wants to buy or sell at a stock exchange must approach a broker-member of the exchange. He is required to furnish bank or other reference regarding his financial position and integrity.

On receiving the order, the broker takes it down in a rough memo book from which it is transferred to the order book.

Bargain : The broker or his authorised clerk goes to that particular part of the hall of exchange and bargains with the dealers of the particular security. When a bargain is closed, both the dealer and the authorised clerk make a briefnoteof the transaction in a small note-book. At the close of day, the authorised clerk enters the details of the transaction in the "Pucca" memo

Book. The broker then prepares a contract note in the prescribed form and signs it himself. A copy of the contract note is sent to the client. On the following day, both the parties compare their contract notes for correctness.

Settlement : Then the contract is settled. Cash transactions are settled on the same day or within a week. This dealing is known as a 'spot' contract or ready delivery contract. The procedure for settlements depends on the type of securities dealt in. Cleared securities are settled through the Clearing House in the exchange. The mutual claims are set off one against another, and the parties pay or receive only the net dues. Usually active securities are cleared through the Clearing House. The transactions in non cleared securities are settled by hand delivery. That is, the seller gives delivery of the securities sold and the buyer pays the price.

Forward trading : In addition to spot transactions, forward contracts are made in stock exchanges. Forward trading is an agreement to give delivery at a future date. Forward delivery contracts are usually entered in to even without the intention of taking or giving delivery of securities. They are squared up later with a conrresponding selling or buying deal.

The forward contracts are settled on fixed settlement days every month. The parties, by mutual consent, may postpone the sttlement to the next period. Such postponement is called 'carry-over or 'budla',

The settlement of forward contracts usually extends over a period of six days : The first day is used for the carry-over of trasactions. The second day, is known as 'Ticket Day' or the "Name Day", when tickets showing the names of actual buyers of securities are handed over to the dealer for making transfers in the proper names. On the third and fourth days, ducuments are prepared and the securities are delivered to the clearing house. The fifth day is known as the Pay Day or Account Day. On this day the members submit statements of account : claims are set off one against another and the net amount is debited or credited to the account of the person concerned. On the last day, known as the 'Settlement Day' the members receive payments and securities from the Clearing House.

Carry-over or Budla : This means postponement of the settlement of a transaction to the next settlement day. The party which seeks carry over pays a charge called budla charge to the other party. The budla charge paid by a buyer for not making the payment of the amount and taking delivery is known as contango, while the budla charge paid by a seller for not giving delivery of securities sold is called back-wardation.

Check your progress - 3

What is meant by forward trading ?

22.3.7 Speculative Transactions

Speculation is carried on through the following types of specialised transaction :

Option Dealings : This business means a right to buy or sell certain securities at a certain price within a certain time. It may be a call option, i.e., an option to buy securities, or a put option, i.e., a right to sell securities, or double or put and called option either to buy or to sell a certain number of securities at a certain price before an agreed date. The speculator who secures an option has to pay a premium known as the option money. When a speculator expects a rise in price, he may by a call option. When the price rises as expected he will exercise an option and buy the securities at the agreed lower price and sell them at a higher price. If, however, the price does not rise he may not exercise his option to buy. Similarly, a put option is secured by a speculator who expects a fall in prices. If the option is not exercised : the speculator will lose only the option money.

The Securities Contracts (Regulation) Act of 1956 prohibits option dealing and declared it illegal.

Margin trading : This is a system of purchasing securities with funds borrowed from the brokers. The client opens an account makes a deposit of cash or securities in this account and agrees to maintain a margin of balance at a certain level. When he asks the broker to buy securities on his behalf his account is debited with the amount of such securities. On a rise in the market price of such securities, the client may ask the broker to dispose of his holdings. The broker may sell them and credit the client's account with the sale proceeds. Now the client has a bigger margin for further purchases. If the price falls, the margin gets reduced. If it goes blow the minimum margin agreed upon, the broker calls upon the client to make it up by an additional deposit.

Margin system : The term 'margin' is also applied to the deposits which the members are required to maintain with the Clearing House of the stock exchange. This deposit is related to the amounts of dealings of the members. The purpose of this margin system is to restrain overtrading in speculative securities.

Cover System : The cover is a deposit made by a client at a certain rate/percent to a broker with instructions to buy or sell on his behalf. The deposit is made with the implied condition that in case the market moves against the dealer the loss is covered out of the deposit. If, on the other hand, the transaction proves profitable, the client receives the profit plus the cover money. Thus cover mony is different from the option money. While cover money is returnable along with the profits, option money is not returnable and retained as a premium for granting the option.

Arbitrage : This is trading in securities to make profits out of differences in their prices in two markets. The speculator simultaneously buys in the cheaper market and sells in the other market and earns a profit. This dealing is highly technical and is undertaken only by skilled speculators.

Wash sales : This is a kind of fictitious transactions in which a speculator sells a security and then buys it at a higher price through another broker with a view to creating a misleading opinion about its price in the market. As a result of such opinion, the price records a further rise and the speculator earns profits by selling his holding to ' public. This is an undersirable dealing and so the rules of stock exchanges provide for severe penalty for such a dealing.

Cornering : A corner is the condition of the market in which almost the entire supply of a security is held by an individual or group of individuals. In such situation, the bears, who have contracted to sell the security without actually possessing it, would be unable to deliver it to the buyers who have cornered the market. The buyers will, therefore, be in a position to dictate terms to bears. Thus the bears are squeezed. This is an undersirable activity.

Rigging the market : This means the artificial forcing up of the market value of a particular security by a strong bullish movement. Speculators holding large blocks of securities buy and sell to 'make a market, and gradually 'unload' thier holdings

Blank transfer : When shars are sold by a shareholder to another person a transfer deed is prepared and filed with the company. In the company, the shares are registered on the name of the transferee. When, however, the transferor merely signs the transfer form, and does not fill in the name of the transferee, it is known as a blank transfer. This transfer facilitates forward trading. A person who buys shares temporarily as part of a carryover operation need not take the trouble of getting the shares registered . This system of blank transfers has encouraged unhealthy speculation. Hence this is discouraged by the strict provisions in the Companies Act regarding transfer of shares.

22.4 PRODUCE (OR COMMODITY) EXCHANGES

22.4.1 Meaning

A produce or commodity exchange is a specialised organised market for the purchase and sale of certain commodities. As explained in the previous section, only certain types of commodities which possess certain characteristics like homogeneity, durability; gradability, etc., are suitable for a commodity exchange.

It is usually organised as a profit sharing or non profit sharing company registered under the Companies Act ; East India Cotton Association , Bombay, East India Jute and Hessan Exchange, Calcutta; and Bombay Oilseeds and oil Exchange may be cited as typical examples.

The membership of produce exchange is acquired by purchasing a share and paying the prescribed membership fees

A member may be a broker, a jobber, a wholesaler, a retailer, an importer or an exporter.

22.4.2 Functions

The main functions of commodity exchanges are :

1. They provide a convenient place for the members to meet for trading and exchange views.
2. They collect and disseminate market information.
3. They establish and enforce rules and regulations for conducting business on sound lines.
4. They establish and maintain grades
5. They provide machinery for the arbitration and settlement of trade disuptes.
6. They help for crystallise market values by bringing about an interplay of the forces of demand and supply, and thus serve as barometers of the market conditions.

22.4.3 Services or Benefits

The produce exchanges provide a ready and continuous market for the purchase and sale of commodities. They impart the quality of liquidity to the commodities, which facilitates raising of funds from bankers on the security of commodities. The exchanges provide and opportunity to trader to shift or transfer their risks to professional risk bearers, i.e., speculators. They offer a useful method of insurance or protection against price fluctuations by means of hedging transactions. They also provide facilites for transferring hedges from one market to another market for arbitrage and thus equalise the price levels of commodities at various centres.

Forward Trading : Besides cash or spot trasactions future transactions are also carried on. A spot trasaction is a contract of sale and it involves payment of a price on the spot or within a week.

A 'future' transaction is an agreement to sell or buy a particular commodity at a specified future date. This trading is done in units of round lots, say 50 quintals or 100 bales, as specified in the rules of the exchange. The agreement is always made with reference to a certain trading month as adopted by the exchange such as December, March. The seller is free to deliver or settle on any day of the trading month for which the delivery was fixed. The terms of future contracts other than the price are laid down by the exchange.

Futures are entered into for the purpose of either speculation or hedging. They are usually restricted to one or two ideal grades of a commodity. It is rare for actual delivery to take place, and the settlement is usually made by payment of differences.

Speculative trasactions, as in a stock exchange may be foreward or option or arbitrage or budla. These terms have already been explained in the previous section on stock exchange.

The principal advantage of forward trading are : Firstly, it enables large purchases and sales of goods to be made in advance of delivery and even in advance of production and thus widens the market. Secondly, it promotes smooth adjustments of the demand and supply and thus eliminates rapid and violent fluctuations in prices and provides a certtain measure of stability. Thirdly it enables traders to cover losses arising out of changes in prices by hedging. Lastly, the future commodity prices, being based on forecasts, also serve as a valuable guide to producers and manufacturers. Traders can adjust their stock according to the indications given by the future markets. Thus the future market brings about the co-ordination of the current and future requirements of the commodity through appropriate adjustment of stocks in the light of the expected supply and demand positions.

22.4.4 Hedging

This is a kind of operation practised by traders to protect themselves against a loss arising out of unforeseen changes in price. Hedging involves making of two opposite contracts simultaneously : one genuine trade contract in the spot or cash market, and the other the opposite but corresponding one in the future market. Thus, if a trader buys a certain commodity in the spot market, he enters into a corresponding agreement to sell in the future market. The latter serves as a hedge or protection against the specultative loss arising out of the former. Hedging helps growers, traders, importers, exporters and manufacturers to protect themselves against losses which might result from price fluctuation. Suppose a flour manufacturer buys wheat at the current price as raw-material for his mill. If the price of grain falls before his flour is sold he may have to sell the flour at a lower price, since the price of flour ussually falls when the price of grain falls. In order to cover this risk, the manufacturer 'hedges' his purchase of 'sport' grain by making another contract to sell grain in 'the future'. If the price of grain falls before he is ready for the sale, he will lose in his product, but he gains on his 'future' contract by buying 'spot' grain at a lower price to settle the future contract. Thus he is able to cover the loss on his flour transaction by the profit on his 'future' contract.

The effect of a 'hedge' is to ensure the trader of his normal trading profit and eliminate any speculative profit or loss due to price changes. Unlike speculation, hedging is always preceded by a genuine trade contract.

Check your progress-4

What is meant by Hedging?

22.4.5 Regulation of produce exchanges

During the Second World War, the Government of India, banned forward trading in essential commodities like oilseeds, vegetable oils, foodgrains, sugar, cotton etc. At the end of the War, the ban was continued by enacting the Essentaial Supplies Act in 1946. In 1952 the Forward Contracts (Regulation) Act was passed to introduce a comprehensive control of future trading in commodities. In order to excercise a stricter control over the working of forward trading, the Act was amended in 1960. Under the Act, a Forward Markets Commission has been set-up to maintain control over and regulate trading in poroduce exchanges.

All exchanges for forward contracts are required to be recognised by the Central Government on the recommendation of Forward Markets Commission. Recognised exchanges cannot conduct business without the approval of the commission.

The Central Government is empowered to approve and amend the bylaws of the recognised exchange. Call for periodical returns, suspend their business in certain emergencies. The government may ban future trading in a commodity.

Option dealings in commodities have been declared illegal.

The purpose of the regulation of future markets is to prevent unhealthy speculation and manipulation of prices, and to avoid risks of defaults.

22.5 SUMMING UP

The organised markets have come into the scene to prevent the unhealthy practices in the transactions of the business. As these markets are functioning in a set of rules and regulations, there is every possibility for the check in the operation. These markets would try for healthy atmosphere in the business practies and reduces the manipulation and risks. The Government can intervene in the functioning of these markets and amend the rules for the social good if necessary.

22.6 CHECK YOUR PROGRESS : MODEL ANSWERS

1. Stock Exchanges and produce exchanges
2. It means buying or selling securties in the hope of a profit from anticipated changes in price.
3. It is an agreement to give delivery at a future date.
4. It is practised by traders to protect themselves against a loss arising out of unforseen changes in price.

22.7 MODEL EXAMINATION QUESTIONS

A) ESSAY QUESTIONS :

1. Discuss the functions of a stock exchange.

2. Discuss the economics of speculation.
3. Discuss the functions of commodity exchanges.
4. Describe 'hedging' and state its advantages.

B) SHORT QUESTIONS :

5. What is an organised market?
6. Who are remisers?
7. What is meant by the listing of securities?
8. Who is a bull?
9. Who is a lame duck?
10. Who is a stag?

22.8 RECOMMENDED BOOKS

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22.9 GLOSSARY

Exchange Rate	:	the rate at which one country's currency is exchanged for another country's currency
Heding	:	purchase of a certain quantity in the spot or future market and the simultaneous sale of a similarquantity in the opposite market for protection against a price change risk.
Product Life Cycle	:	the stages in the life of a product from introduction to decline
Warehouse	:	an organisation which provides storage for a charge.

BLOCK-V BUSINESS MANAGEMENT

UNIT 23 : INTRODUCTION TO MANAGEMENT

Contents

23.0 AIMS AND OBJECTIVES

This unit gives a description of management and explains the importance and functions of management. After going through this unit, you will be able to :

- Understand the Concept of Management
- Explain Meaning of Management and Administration
- Mentioı about the Management,
- Identify the functions of Management.

23.1 INTRODUCTION

Management is the most fundamental and at the same time,the most neglected activity in all societies. It can probably be traced to the beginning of the human history. since the theme is made up of two words 'Man and Age'. As it is a universal characteristic of all organised human living, It is found in all sphères of human activity. The management process may be said to have begun with the family and later extended to the tribe before encompassing formalised organisations like churches, clubs, games, expeditions, armies, hospitals, Universities, Government, business and such other collective or group activities.

Management fulfils the need of the human society to organise its resources-Physical, financial, technological and human for its betterment. But management in the present time is unlike that of the earlier time when it centred on persoanl leadership, since it is a specific collective organised effort calculated to eliminate conflicts and tenstions. It may be seen that the management process has evolved as man first as an individual (sole proprietor) and later as collective group (Corporation) attempted to organise to achieve the best possible results (division of labour and specialisation). Further, management has also helped man even to control the environment although in fact, he has had no control even on himself in the early days. The management is, thus, a dynamic factor of organisation for fulfilling the common purpose through the most effective use of the available resources.

MANAGEMENT

INPUTS or RESOURCES		OUTPUTS or GOALS OR END RESULTS
Physical	CONVERTING TO →	Goods
Financial		Services
Technological		Profits
Human		Satisfaction

Further, in a competitive business world, management has assumed a distinct and dominant role. The survival of the business, indeed, is determined by the effectiveness of its management. Thus, management has surpassed the capital in importance with the result that now people talk of "Management and Labour" instead of "Capital and Labour".

It is indisputable that the knowledge of management has been highly useful and that the practice of management has been remarkably successful in harnessing human energy and converting the potential provided by nature into useful forms for the society. However there are a number of difficulties in adopting it to changes in technology and environment. In the present time management has to ask itself several questions like the following:

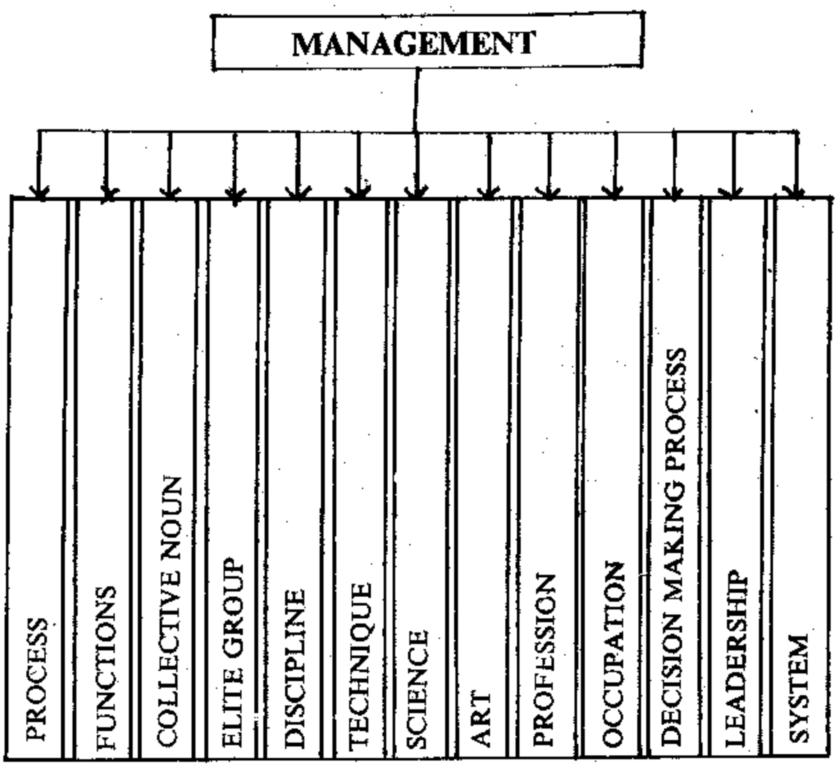
Can we do better than what we have been doing at present?
Can we improve the efficiency of our operations?
Can we develop better relations with the employees?
Can we meet the challenge of changes predicted or unpredicted?
Can we make better use of our science as well as abundant resources than at present?
Can we reduce the strain of organisational life on the human system?

There is evidence that the rapid changes in managerial information systems, decision making processes, organisational innovations can answer the above mentioned questions in an affirmative way. The professionalisation of management can definitely need this kind of challenge.

23.2 MEANING AND DEFINITION OF MANAGEMENT

23.2.1 Meaning

The word, 'Management', has been viewed in several ways both by theoriticians and practitioners, as it is a complete and abstract concept. Differences arise because of contemporary conditions and experiences but not because of changes in the subject matter or the philosophy of management. Inspite of its varied meanings and connotations, management can be understood from a practical and technical points of view as a process consisting of various functions. Further, the management is not specific, static and constant, since it changes with the subjective and objective standards. That is why the inexplicability of management is explained as "Management is what management does" like "money is what money does". As the concept of management cannot be defined comprehensively each author has given his/her own view of it and the concept itself may undergo changes. Consequently, the term, 'management' has been given varied meanings by different people. It is used as a collective noun to refer to all those who manage within a particular organisation including those who help like managers. Management is also used to refer to a particular activity such as scientific management or a specialised function like production, selling, etc. It is also considered a special class or an elite group standing apart form other groups like labour and owners, it has been often recognised as a process, function, system, skill, discipline, technique, science, art, occupation and profession. Management is also recognised as a decision making process or controlling activity and a leadership function.



23.2.2 Definition

Management is defined in many ways. It is "a technique by means of which the purposes and objectives of a particular human group are determined, classified and effectuated" (E. Peterson and E.G. Plowman). It is "getting things done through and with people" (Harold D. Koontz). It is "a multi-purpose organ that manages a business and managers, manages workers and work" (P.F. Drucker). It is "the art of securing maximum results with a minimum of effort so as to secure maximum prosperity and happiness for both employer and employee and give the public the best possible service" (John F. Mee), it is "principally a task of planning, coordinating, motivating and controlling the efforts of others towards a specific objective" (J Lundy). it is "the development of people and not the direction of things" (L. Appley). It is "the function of executive leadership anywhere" (R.C. Davis). It is "a distinct process consisting of planning, organising, actuating and controlling performed to determine and accomplish the objectives by the use of people and resources" (George R. Terry). It is "a process of setting and achieving objectives by influencing the human behaviour with a suitable environment on the working basis according to their needs and circumstances" (Claude S. George Jr.). Though the meanings and definitions of 'management' vary in the writings of management specialists, the philosophy is one and the same and the differences exist only in their approaches to it. This is but to be expected because of its complexity elusiveness and abstractness and because of its being interpreted and defined in different dimensions.

Check your progress-1

Define Management

23.3 MANAGEMENT Vs. ADMINISTRATION

The term, 'managemet', is often used interchageably with the term, 'administration and organisation'. Some efforts have been made to distinguish these terms from each other.

According to the American school of thougt,Administration is considered to be a top level function. It is concerned with 'Thinking' or determination of the overall objectives, plans and policies. It concentrates on coordination of various functional activities like production, distribution, finance and personnel. Simultaneously, the term, 'mnagement', is conceived as a 'doing' function concerned with the execution of objectives, plans and policies.

On the other hand, according to the English school of thought, management is a genetic term embracing administration. Administration, thus, has become a part of management. Accordingly management is classified into two categories.

(i) Administrative management (represented by top level management involving thninking activity);

(ii) Operative management (represented by lower level management involving doing activity).

However, it has been resolved by Drucker on the basis of their practical use. The term, 'management' may be used in the business enterprise whose main activity is production and distribution of economic goods or services, where as the term, 'Administration', may be used in the context of other institutions like the Police Department, the Income Tax Department, etc. It is argued that management is essentially an activity which improves and maintains the wealth producing capacity of the economic resources where as administration deals with those activities which primarily have objectives other than economic results.

23.4 NEED FOR MANAGEMENT

Managing is essential at all levels or organised undertakings. However there are alo doubts about the need for managing. Some people believe that people would work together better and with more personal satisfaction if there are no Managers. They refer to this ideal group operation as 'team effort'. Despite this belief in "team effoft" or 'self cooperation', management is indispensable to every organised group effort in order to achieve clear-cut goals at the least cost of time, money effort, material and discomfort. Thus, there is a dire need for establishing the environment suited to the attainment of goals of the group and individuals without much wastage at resources. Further, the need for managing is the same in all kinds of institutions whether they manufacture goods or render services. Wherever the group effort is required to achieve goals, the management must harness this effort in order to avoid wastage or inefficiency. The purpose of management is to achieve certain specific ends and to maintain or improve the ability of an organisation for achieving the objectives. Thus, management has a long-term orientation and most of its decisions are made for future. As a process, it has to utilise the human and other resources toward specific objectives.

23.5 NATURE AND THE ROLE OF MANAGEMENT

23.5.1 Nature

The nature of management can be understood in five dimensions, viz., (1) Overall approach, (2) Universality, (3) Science, (4) Art and Profession.

1. Overall Approach : Management is not confined to a specific functional or technical activity **like that of an accountant, statistician, doctor, or an engineer, but it is overall in its approach covering all functions and balancing all the activities.**

(2) Universality Management is universal in its application and adoption. It is indiscipensable not only to business enterprises but also to churches, homes, schools, trade union, Governments, clubs etc. The heads of all these institutions do the same managerial job. Further, even among the business enterprises the knowledge of it is transferable. The managerial activity of a beedi factory does not differ from that of the steel mill.

3. Science : Management is reorganised as a science, since it possesses a 'systematised body of knowledge' with a set of principles, functions and tecnniques.

(4) Art : Management is an art as it deals with the creative activity of human beings for a better end-result and well-being.

(5) Profession : If management is both a science and an art the question is whether it is a profession. The basic characteristics of a profession are (i) existence of a systematised body of knowledge; (ii) compulsory acquisition of that knowledge. (iii) ethical values of the member and (iv) the service motive rather than personal benefit. Thus a profession is an occupation requiring extensive education and training in a branch of science or liberal arts. Though, in the strictest sense, management cannot be considered a profession like medicine or law owing to lack of uniform code of conduct or licensing every manager is expected to acquire the requisite professional knowledge or taining so as to attain the status of a professional.

23.5.2 The Role of Management

The role of management today is much more complicated than in the earlier years because of severe competition for survival on one hand and scarcity of resources for achieving the goals on the other. It is to be viewed from three angles, viz; (1) An economic resource, (2) A system of authority and (3) A class or an elite.

The management which is a coordinating function of all the other activities has to bring all the resources together in order to produce goods or services for the satisfaction of human wants. But for the management, the productive resources (materials, machinery, money, methods and men) remain resources and never become goods and services.

23.6 FUNCTIONS OF MANAGEMENT

23.6.1 INTRODUCTION

Recognising the need for a unifying philosophy of management in a growing competitive business world, management experts have developed ageneral theory of management consisting of various principles, functions and techniques of management. This development has been accelerated specially since the beginning of the Wrodl War II. In this process,the knowledge, experience and skills of each generation are passed on to the next, thereby developing management into a profession. The result of these exercises has been the coinage of several functions of management. This happens because most writers begin from different vantage points use different premises and end up with results that do not fit together with those of other writers. Thus, the managing process is presently designed by different authors so as to embody a number of management functions.

For instance, Henry Fayol has divided the management into five functions viz; Planning, organising, coordinating, commanding and Control. James Lundy in his famous work, 'Effective industrial Management', has observed four functions, viz., Planning,Coordinnating, Motivating and Controlling. George R. Terry has described them as planning, organising, actuating and controlling. Luther Gullick, the first Director of National Institute of Public Administration, USA and also President of Roosevelt Committee on Administrative Management has coined a catch-word, 'POSDCORB', to explain its executive functions :

P-Planning
O-Organising
S-Staffing
D-Directing
Co-Coordination
R-Reporting
B-Budgeting

Ernest Dale has designated its functions as planning, organising, staffing, direction, control, innovation, and representation. In his opinion,there are a few other functions which can be termed 'sub-functions'. Koontz and O Donnel have classified the functions as planning, organising, staffing, leading and controlling. The hand book on management has listed out forty-four functions of management. However, whatever be the number of functions proposed by various methods and whatever be the nature of importance given to certain functions, all these can be grouped into three basic activities and functions, which a manager must accomplish:

A manager must PLAN
A manager must EXECUTE
A manager must REVIEW

Depsite the fact that several functions have been attached to management, the slection of a few functions like planning, organising, staffing, directing and controlling would be helpful as specified in a standard text book written by Koontz and O' Donnell, of course, the other complementary and resultant functions will be part of the above mentioned functions. For example, Forecasting and decision-making are part of planning. Further, direction includes leadership, motivation and communication. Of course there cannot be any objection to treating control as the last function.

23.6.2 Planning

Planning is the first function of management process. Planning looks ahead into the future. It predicts the future environment. It is a process of setting as objectives and deciding the future actions, it establishes guidelines for future actions. It suggests methods for the attainment of objectives. It formulates the programmes and clarifies the producers. In other words, it determines what is to be done, how it is to be done, when it is to be done, by whom it is to be done, where is it to be done and why it is to be done. Planning is done by all the managers at all levels of the organisation. Planning may cover any duration from the shortest period of time, say an hour, to the longest period of time, say a century.

23.6.3 Organising

Human beings group themselves into several organisations that will enable them to carry out the plans successfully in order to achieve the individual and organisation objectives. A formal organisation is an association of human beings working together for achieving the desired goals. Which cannot be achieved individually. Organisation draws the resources (inputs) physical, financial, technological and human forms the environment and releases the goods and services (outputs) for the satisfaction of human needs. Every organisation involves structural and functional activities. However, organising is the process of establishing realtionships both horizontally and vertically in a formally organised enterprise.

23.6.4 Staffing

Staffing has come to be recognised as a separate function only in the 20th century, thoug it is a part of organisation. It attempts to fill in the organisational roles with suitable people in order to achieve the organisational goals. It is the responsibility of every manager at every level to involve himself in the process of staffing. The process of staffing includes activities like manpower planning, recruitment, selection, training, compensation, promotion, etc. A change in the organisational roles and its functioning will also bring about a change in the staffing function.

23.6.5 Direction

Functions like planning, organising and staffing undertake only some preparatory work, but 'Directing' is a movement forward to achieve the end results. It is not a specific function. It is a complex activity involving the leadership by which a manager guides and influences his subordinates, Precisely, it covers :

(i) communication of orders, instructions, commands, ideas and praise from the supreior to the subordinates, suggestions, feelings sentiments and grievances from the subordinates to the superior.

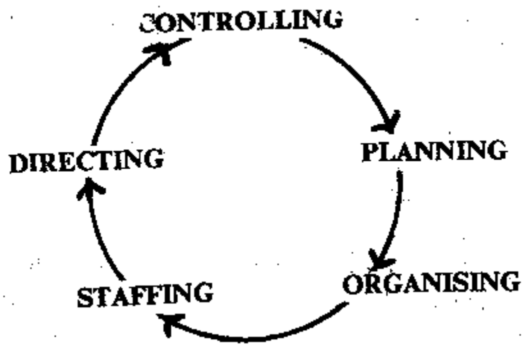
(ii) motivating the employees so as to enable them to do the work to the best of their ability and building up of morale and maintenace of discipline,

(iii) Coordinating all the divided activities of the individuals and groups in order to produce a harmonious effort.

23.6.6 Controlling

It is the last function which involves the manager to ensure that the objectives are achieved in conformity with the plans formulated, policies laid down and standards established. It is thus that controlling looks back. It reviews the performance and compares it with the obective standards in order to find out the gaps and deviations if any. This is necessary in order (i) to make sure that the objectives and plans which have been set in the past are achieved and (ii) to set the future objectives and plans with necessary modifications based on the past experience. This is how planning and control are wedded together through the management process. By completing the control function the manager completes the cycle of management.

MANAGEMENT CYCLE



Check your progress-2

List out the various functions of Management.

23.7 SUMMING UP

Management is an executive function of any concern. It is both art and science. The need for effective management is essential in order to put the whole cylce operation in a fitting manner. Management functions are divided into planning, organising, staffing, directing, co-ordination, Reporting and Budgeting. These functions operate in the organisation as a cyclical sequence and produce the results. The mangement cycle is completed when the Control function is completed.

23.8 CHECK YOUR PROGRESS-MODEL ANSWERS

1. Peter F. Drucker defines Management, a multipurpose organ that manages a business and managers, manages workers and work.
2. Planning, organising, staffing, directing, coordination, reporting and budgeting.

23.9 MODEL EXAMINATION QUESTIONS

A) ESSAY QUESTIONS :

1. Comment on the true nature of mangement, Is it a Science or an Art?
2. Discuss the importance of Management in the present day world.
3. Explain the process of Management.
4. Explain briefly the various functions of Management.
5. State the basic principles of Management.

B) SHORT QUESTIONS

6. What is meant by management?
7. What is meant by Administration?
8. List out the functions of management?
9. List out various schools of thought.

23.10 RECOMMENDED BOOKS

1. KOONTZ, H., O'DONNEL, C and WEIHRICH, H; Management, VII Ed., Mc Graw Hill International Book Company, New Delhi, 1980.
2. Sharlekar, S.A. and Sharlekar, V.S; Prinicıples of Busıness Management. Himalaya Publishing House, Bombay, 1983.
3. Srinivasan, R. and Chunewalla, S.A; Management-Principles and Practices. Himalaya Publishing House, Bombay, 1983.
4. TRIPATHI, P.C. and REDDY, P.N; Principles of Management, Tata Mc Graw-Hill Publishing Co. Ltd. New Delhi, 1983.

23.11 GLOSSARY

ADMINISTRATION	:	High-level body dealing with and formulating policies.
ADMINISTRATVIE MANGEMENT	:	Representing top-level Management involving thinking.
AUTHORITY	:	Right to issue orders and power to exact obedience
BUDGETING	:	A technique involving anticipated revenues and anticipated expenditure
CENTRALISATION	:	Concentration of decision making authority in a single individual or a few individuals
COMMUNICATION	:	The process by which management functions are performed through exchange of information and the enabling of managers to take decisions,
CONTROL	:	The process through which mangers assure that actual activities conform to planned activities.
CO-ORDINATION	:	An information processing task where by activities of different units get harmonised and friction reduced.
DECENTRALISATION	:	The process of dispersing decision making authority throughout the length and breadth of the organisation or decision-making provided at various action points.
DIRECTING	:	Getting things done through others by leadership and communication process and motivating the employees.

UNIT - 24: PRINCIPLES OF MANAGEMENT

Contents

24.0 AIMS AND OBJECTIVES

The aims of this unit is to familarize the principles of management as given by Henery & Fayol.

On completion of this unit, You should be able to:

- explain the principles of management as given by & Fayol.
- judge whether the principles of Fayol are principles of generalisation.

24.1 INTODUCTION

In Unit No 25, it is stated that scientific management is mainly concerned with the increasing of the productivity of the worker, particularly at the shopfloor level. But the need for managing complex undertakings as a whole has been felt. It was Fayol, who was the first to systematise this and provide guidelines for managing complex undertakings. He believe that sound managerial pratices fall into certain identifible patterns, which he feels can be analysed. Fayol joined a coal and iron combine as a junor manager and reached the top. He felt that 'with scientific forecasting and proper methods of management, satisfactory results were inevitable'.

Fayol felt that management was more a skill than a talent. He felt that management could be taught, and accordingly spent much of his time to porve it. Many of the managerial concepts taught today were first articulated and discussed by Fayol.

24.2 THE ACTIVITES OF BUSINESS

Fayol divided the various business operations into six activities. These activities are closely inter-related They are:

1) Technical activities (production, manufacture and adaptation)
2) Commercial activities (buying, selling and exchange)
3) Financial activities (acquiring capital and its optimum use)
4) Security activities (protection of employees and property)
5) Accounting activities (stocking, Balance Sheet, Costs, statistics, etc.)
6) Managerial activities (or administrative activities.)

Fayol's primary focus was on the managerial activities. He felt that managerial skills were the post neglected aspect of business operations.

He defined 'managing ' in terms of five functions, vix., Planning. Organissing, Commanding, Coordinating and Controlling. Here, planning implies designing a course of action that will enable the organisation to achieve its goals, 'organisng' means mobilising the material and human resources of the organisation for implementing the plans. 'Commanding' refers to the direction given to the employees and getting the work done by them. 'Coordinating' is ensuring harmony in the various activities which contribute to the achievement of the desired goals, and Controlling means monitoring the plans so as to ensure that they are implemented properly.

Chart : 9 OPERATION OF BUSINESS

OPERATIN OF BUSINESS

Technical Activities | Commercial Activities | Financial Activities | Security Activities | Accounting Activities | Management Activities

Planning | Organising | Commanding | Co-ordinating | Controlling

Fayol has furthur observed that abilities needed by managers in a given organisation vary and that they are dependent on their positions in the managerial hierarchy. Managerial hierarchy refers to the level or position which a manager holds and is usually in an ascending order. At the lower level, managers may require specific technical skills but very little managerial ability. As managers go up in the hierarchy, they require more managerial abilities but less techinical skills as compared with lower level managers. He also has felt that the need for managerial abilities is related to the size of the organisation. In other words, managers in a large business undertaking require a grater measure of managerial skills than those in a small one. Hence as the number of business houses increases the need for more and better managers would increase. He, therefore, suggested the introduction of formal managerial training in schools. He, furthur, thought that managerial ability could be universally applied in the house, church, military as in the industry.

The managerial activities determine the intrinsic worth of other activities. For example, organising ability is essential for making the undertaking successful and profitable. Similarly, producing, selling,financing and accounting activities becomes effective only when they are scientifically planned, systematically organised, carefully coordinated and effectively directed and controlled.

Those mentioned above are delicate managerial tasks. To understand them and put them into practice, one need to observe certain norms and standards. In today's world, management is not a one man show. It is increasingly becoming a multi-level process of specialisation authority and responsibility. Which are systematically spread over the entire enterprises. To achieve the goals effectively and efficiently management has to create the needed administrative set-up.

For creating the requisite administrative set up, certain principles have to be followed which in general, constitute the principles of management as given by Fayol. As principles of management, Fayol chose the fourteen which he 'most' frequently had to apply. They are:

24.3 FOURTEEN PRINCIPLES

FAYOL'S 14 PRINCIPLES OF MANAGEMENT:

1. Division of labour
2. Authority
3. Discipline
4. Unity of command
5. Unity of Direction
6. Subordination of individual Interest to the common goal
7. Remuneration
8. Centralisation
9. The Hierarchy
10. Order
11. Equity
12. Stability of staff
13. Initiative
14. Esprit de corps

24.3.1 Divisions of Labour

This principle leads to specialisation.The advantage of division of labour cannot be overemphasised. Wherever large scale production is attempted, work is assigned to the workers as per their aptitude and specialisation. This principle is applicable to all types of work and is not exclusiverly confined to technical work alone. The benefits of division of labour are known to everyone, but their limitations should not be ignored.

24.3.2 Authority

Management is the art of getting things don through and with others. This means that others are to be directed to carry out a particular activity in a particular way. For this purpose, managers need authority, which they exercise over others to get the work don. Authority is the right to isssue orders and the power to exact obedience. Managerial position becomes effective only when it has the requisite authority and when it is exercised by them.

According to Fayol authority has two dimesions viz., the positional and the personal. The manager derives his positional authority from the position he occupies in the organisation. Experience, moral values and the capacity to direct people effectively enable a manager to acquire personal authority makes a manager allthe more effective and reinforces his positional authority.

24.3.3. Authority and responsibility .

They should go hand in hand. Resoonsibility implies obligation to perform the work in the manner desired and directed by superior authorities. Authority and responsibility are coextensive in other words, there is parity between them. Responsibility is therefore both the person who exercises the authority and the person over whom the authority is exercised. Further, there should be sufficient safeguards and restrictions in the exercise of authority. If such restrictions are not provided, there is a possibility of authority being misused. However, it is suggested that it is difficult to implement restrictions in large-sized undertakings.

24.3.4 Discipline

Obeying the rules and respecting the authority is the essence of discipline. In order to secure discipline in an undertaking three things are required; first there should be good managers at all levels and in all positions; secondly, the necessary restricitions and penalties to be imposed should be fairly and equitebleimplemented without any discrimination; thirdly, there should be clear and equitable agreements between the employees and the enterprises. It further observed that if any enterprise is to grow and function smoothly, discipline is essential and over and above that 'discipline is what the leaders make it. Moreover, discipline would be better if it is self imposed than if it is imposed from above.

24.3.5 Unity of Comand

This principle states that employees should receive orders from one superior only for any activity,in other words, employees should not work under two bosses or superiors. If they do so, their standards of performance may be affected. Further,any apreciabledegree of discipline cannot be guaranteed. Dual command is not desirable. As pointed out by Fayol, 'as soon as two superiors exercise their authority over the same person or department, uneasiness makes itself felt the disorder increases'. The personnel get confused, if they are to report to more than one boss. Further responsibility can be pinpointed only when a subordinate works under a single superior. Observance of this principle enables the executives to exercise their authority effectively, enables the organisation to fix responsibility precisely and provides orderliness in work, and discipline among the subordinates.

Check your progress - 1.

What do you mean by Unity of Command?

24.3.6 Unity of Direction

Very often this principle is confused with unity of command. Unity of command principle is concerned with the personnel. Whereas unity of direction is concerned with body corporate. It implies that each group of activities having the same objective must have one head and one plan. In other words, there should be one plan of action for each category of work which should be executed under the overall control and supervision of one head or superior.

24.3.7 Subordination of Individual Interest to General Interest

In any business enterprise, management should make every effort to protect the common interest and iron our individual differences among the member s. This enables the enterprise to achieve unity and reach its goals smoothly, Common interest over individual interest can be secured by (1) ensuring that good examples are set by supervisors. (2) having fair and legitimate agreements and (3) having continuous supervision.

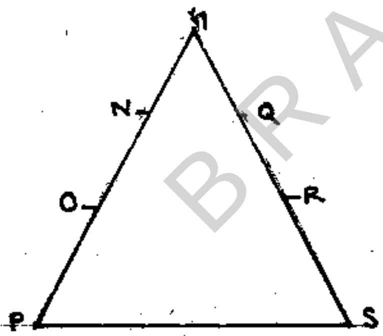
24.3.8 Remuneration

 It is the price paid to the personnel for the service rendered by them to the concern. It should be fair and provide maximum possible satisfaction to the employees, It should be remembered that contented staff is a substaintial asset to the organisation. The salary or wages paid to the employees should be fair and satisfactory, otherwise, the employees maynot do justice to their jobs. Fair remuneration to the employees motivates them.

24.3.9 Centralisation

'Everything which goes to increase the importance of the subordinate's role is decentralisation, everything which goes to reduce it is centralisation.' In other words, the issue of centralisation is concerned with the concentration of decision-making authority in a single individual or a few individuals depending on the nature of circumstances, size of the undertaking, the types of different activities, etc. The issue of decision making authority may be vested in either a few officers or delegated to different executives, under centralisation, the importance of the role of the subordinate diminishes but under decentralisation as the decision-making authority is dispersed throughout the enterprise, the role of the subordinates in the decision making process increases.

This principle is more popularly known as the scalar principle. It implies that there is a sort of graded authority running from top to bottom in the organisation in the form of a straight line. In order to service the unity of command and see that there is a flow of communication,this principle is established. If communication and orders are to be transmitted, they should go through the scalar chain. For example, in an organisation the Managing Director is the highest authority; below him is the General Manager; below him is the Financial controller followed by the Chief Accounts officer and Accounts officer. If the accounts Officer is to send any information to the Managing Director, he has to send it through the Chief Accounts Officer, the Financial Controller, the General Manager and finally the Managing Director, Similarly, the authority flows downwards from the Managing Director right down to the Accounts Offcer in a straight line. But such a flow of authority downwards, on flow of communication upwards results in undue delays. Where work has to be carried out quickly without much delay. Fayol has suggested the use of gang plank. By using the gang plank, it becomes possible to do things quickly and secure coordination among the different acrivities. This can be better understood from the following diagram;



In this diagram, if M is to send orders to P, they have to go through the scalar chain; i.e., to N, O, and then to P. If P is to respond to the orders, they have again to go through O and N. This is, obviously, time consuming.
Similarly, if P is to secure any inforation from 's', it has to go through R, O/M and then to N, O and P. This is time consuming. In order to avoid the delay Fayol has suggested the use of gang plank. It implies that P should directly establish connection with 6 instead of going through the hierarchy.

Thus under scalar principle the authority of manager gets graded and the scalar chain establishes the superior-subordinate relationships and communication channels in the organisation.

Check your progress -2

State the scalar Principles

24.3.10 Order

It implies the right man for the right job and right materials for the right thing. Proper placement of personnel enables the organisation to reduce the wastage of materials and equipment. Right place for every thing and for every man' should be an important guidelines for the management. 'Right man for the right job' implies scientific selection of competent personnel and assignment of duties to them respectively. There aretwo thingswhich have to be observed in this regard. First, the positions in the enterprise should not be increased without reason. Secondly, the different positions in the organisation should not be filled up with incompetent people.

24.3.11 Equity

It is nothing but the combination of justice and kindness. Managers while dealing with subordinates, should be kind, impartial and objective. They should not favour any one at the cost of another. Equity can be exercised successfully by those who possess good sense, good nature and experience. Prejudices, personal likes or dislikes, should not influence the managerial treatment of the subordinate personnel. In order to gain the subordinates loyalty and obidiance, euqity is absolutely essential. Equity does not mean that one should not use force. Depending on the situation,the superiors must excercise their authority to secure equity. Equity ensures cordial relations between management and personnel.

Check your progrsss -3

State the equity principle.

24.3.12 Stability of Tenure of Personnel

It is the responsibility of management ro assure security of job to the personnel in the enterprise. When employees feel insecure about their jobs they may not be properly motivated in doing their jobs. Stability of tenure of job removes the sense of insecurity from the minds of employees. It enables them to develop attachment to the firm and their loyalty will be steadfast. Hence, it is necessary that the personnel should continue in their jobs for long periods. If there is a high turnover in personnel in an organisation, it is a poor reflection on the management itself. Hence, Fayol has felt that it is better to have average ability people to be in the organisation for a long time than those who are efficient, but who are not likely to continue in the service in the organisation for long time.

24.3.12 Initiative

This implies the capacity to think out original plans and executed them with complete discretion. It further suggests that employees should be given sufficient opportunity to show their initiative. Fayol describes initiative as one of the keenest satisfactions for an intelligent man to experience. Employees should be encouraged to make suggestions and management should give due weight and consideration to such suggestions while formulating objectives and plans.

24.3.14 Espirt de Corps

It means that 'union is strength' Management should strive for harmony and understanding among the personnel. Unity among the members of the staff is the greatest source of strength for the undertaking. Hence management should not indulge in divide and rule' policy but should create team spirit amongst the employees. A good communicational system is a must in order to promote this in any organisation.

24.2 EVALUATION OF PRINCIPLES

Fayol carefully chose the term, 'Principles of Management,' rather than Rules or Laws of Management. In order to avoid rigidity, in administrative matters there is nothing rigid or absolute. Principles are flexible and can be adapted to meet any need; it is only a question of knowing how to use them and hence it is a matter of proportion depending on different and charging circumstances.

It is pointed out by some that calling them principles is unfair. A principle when applied must produce the same result every where. Thus a principle acquires universality. But such universality is difficult to achieve in management. Hence it is felt that calling them principles is inappropriate and it is therefore suggested that it is more appropriate to call them 'guidelines' generalisationsor proverbs than principles'.

24.5 SUMMING UP

The principles of management are the guiding principles for the functioning of management in any organisation. The observance of these principles could facilitate the smooth functioning of the management'

Further, it is also pointed out that these so called principles are more appropriate for the past than for the present. In the past organisations functioned in a relatively stable and predictable environment. Today organisational environments are turbulent and complex. Change has become a permanent feature. Organisations have become more complex than what they were earlier. Hence these principles could be appropriately applied to the past rather than to the present.

24.6 CHECK YOUR PROGRESS: MODEL ANSWERS

1. This principle says that employees should receive orders from one superior only for any activity. There should not be two bosses or superiors.
2. Scalar principle is a sort of graded authority running from top to bottom in the organisation in the form of straight line.
3. Equity principle is nothing but the combination of justice and kindness. It means the managers should be kind, impartial and objective while dealing with employees.

24.7 MODEL EXAMINATION QUESTIONS

A) ESSAY QUESTIONS:

1. Briefly describe the various principles of management as given by Fayol.
2. Critically evaluate the different principles of Fayol.
3. How far are the principles of Fayol relevant today?
4. How are the various activities of business as classified by Fayol interrelated?

B) SHORT QUESTIONS:

4. How did Fayol define 'managing'?
5. Define authority.
6. State the principle of unity of command.
7. What is meant by 'unity of direction'?
8. State the scalar Principle.
9. State the principle of specilisation.
10. What is gang plank? Why is it used?
11. Explain the equity principle.

24.8 RECOMMENDED BOOKS

1. Drucker P.F; Practice of Management, Allied Publishers, New Delhi, 1970.
2. KOONTZ H., O' DONNEL, C and WEIHRICH, H; Management, VII Ed., Mc Graw Hill International Book Company, New Delhi, 1980.
3. Sharlekar, S.A. and Sharlekar, V.S; Principles of Business Management, Himalaya Publishing House. Bombay, 1983.
4. Srinivasan, R. and Chunewalla, S.A; Management-Principles and Pracrics. Himalaya Publishing House, Bombay, 1983.
5. TRIPATHI, P.C. and REDDY, P.N; Principles of Management, Tata Mc Graw-Hill Publishing Co. Ltd., New Delhi, 1983.

24.9 GLOSSARY

Responsibility	:	Obligation to perform the work in the manner desired and directed by the superior authorities
Scalar Principle	:	Authority running from top to bottom through chain of command and in the form of a straight line
Unity of Command	:	One employee and one boss where the subordinate gets orders or instructions from one superior only
Unity of direction	:	One head and one plan for the same objective
Universality	:	Applicability throughout the world

UNIT-25 : SCIENTIFIC MANAGEMENT

Contents

25.0 AIMS AND OBJECTIVES

This unit gives an account of the concepts, meaning and evaluation of Scientific management. At the end of this unit,you should be able to:

- Explain the concept of Scientific Management
- Understand meaning and elements of Scientific Management
- Describe the elements of the Scientific Management.

25.1 INTRODUCTION

The evolution of management concepts runs almost parallel to the revolution of manufacturing processes. With the advent of the Industrial Revolution, the management of modern large scale business concern has become a complex affair. The efficiency of the unit depends on efficiency of the workers as well as the management practices. According to Jones, it is a body of rules, together with their approrpriate expression in physical and administrative mechanisms and specialized executives, to be operated in co-ordination as a system for the achievement of new strictness in the control and process of production. Accordingly a new system has been evolved and designated as 'Scientific Management'.

The scientific approach for solving the business problems suggests scientific management. It involves the application of a two-fold technique for tackling managerial problem. The first technique is concerned with the discovery of the best method for performing a particular task under the existing conditions of knowledge and organisational ability. The second technique is concerned with the fruitful application of that best method for meeting a given situation. Broadly speaking, scientific management is the art of knowing exactly what is to be done and the best way of doing it.

25.2 MEANING AND DEFINITION OF SCIENTIFIC MANAGEMENT

25.2.1 Meaning

As the very name indicates scientific management means the application of science to the management. At the outset,one should know what is science? What is management? Science is a systematised body of knowledge pertaining to an area of study and contains some general truths. Thus, knowledge comes from experience. Experience comes from observation. Management is a process of utilising the resources for the achievement of desired results. So scientific management involves the careful study and investigation of all the problems affecting the management of the enterprise. This implies the following factors :

(a) finding out the best method of doing particular piece of work.
(b) finding minimum time required to complete the standard work.
(c) Selection of proper worker and giving them the required training.
(d) giving an incentive to the workers to work by giving bonus and reward.

25.2.3 Definition

Fedrick W. Taylor defines Scientific Management as the art of knowing exactly what you want the workers to do and seeing that they do it in the best and cheapest way.

According to Diemer it means 'the obtaining, digesting and arranging all obtained knowledge relating to the conditions, methods, processes in the field of management and developing these into an organised body of principles'.

According to P.F. Drucker "its care is the organised study of work, the analysis of work into its simplest elements and the systematic improvement of the workers performance of each element".

The above definitions explain the objective of scientific management. In simplest terms its prupose is to secure the maximum prosperity for both the employer and the employees in an enterprise. Scientific Management asserts that the interests of labour and management are not antagonistic in their real significance, but are complementary as well as supplementary to each other. Therefore, the scientific management is applicable not only to industrial concerns but also to all economic and social activities.

Check your progress-1

Define Scientific Management as per F.W. Taylor.

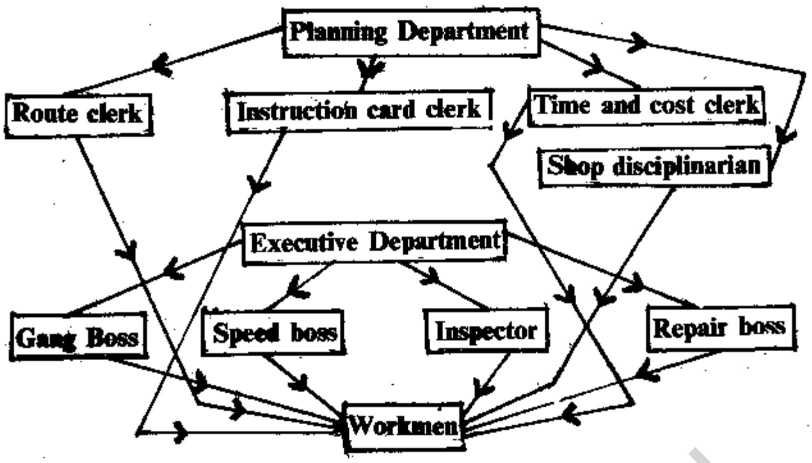
25.3 Evolution of Scientific Management

Under the traditional system of management, the management possessed less skill and technical knowledge than workers. Methods of work followed both by the management and workers were inherited from their ancestors. Because of this, the old system was called as the system of initiative. As against this, the management under scientific management acquires thorough knowledge of the job and takes the responsibility to determine the standard of work for each worker.

The real beginning of a scientific management did not occur untill last decades of the nineteenth century. A group of remarkable persons in the United States. Frederick W. Taylor (shop management, principles of scientific management and on the art of cutting metal) Henry Lawrence Gantt (work, wages and profits), Harrington Emerson (Efficiency and Twelve principles of Efficiency), Frank Bunker Gilberth (Motion study and applied Motion study) and others must be credited with laying the foundation of a management movement which, in due course, became known as scientific management. During the brief period from 1903 to 1919 the teachings of these four great leaders in industry were given to their American Contemporaries and so to the world. Though there was a considerable agreement in their philosophies there has been much divergence in their practices.

25.4 Taylor's Philosophy

F.W. Taylor is considered to be the father of scientific management as he was the first person to introduce scientific methods at the workshop level. Thus, Scientific management is also known as Taylorism. Taylor started his career as a worker but rose by stages to the position of chief Engineer of a mill. As such he could observe, closely the attitudes of workers towards work, wastage of time, the wastage to resources and other inefficiencies and leakages. His efforts to remove these wastages have resulted in the development of scientific management. Taylor, identified the main causes of loss of time as (1) the workers were deliberately slack in performing their work, (2) the methods used for performing the task were crude and unscientific that even willing workers could not produce to the maximum of their capacity. For removing these causes, Taylor suggested the introduction of functional foremanship and divided foremanship into two functions viz., planning and Execution. In the planning section, every task is thoroughly planned and instructions are issued to the workers for implementing them.



Functional Foremen

According to Taylor,there should be eight functional foremen. (1) route clerk (2) instruction card clerk (3) time and cost clerk (4) shop disciplinarian (5) gang boss (6) speed boss (7) Inspector (8) Repair boss.

Plannint Department : The following foremen operate in the planning department.

(1) Route Clerk : He has to lay out the routes or the path of the raw material in the different stages of production. He also fixes the time. He is responsible for that function.
(2) Instruction Card Clerk : He prepares the instruction cards which inform the workers about the minute details of the work, the tools to be used, the speed to be maintained etc;
(3) Time and cost clerk : The clerk with help of instruction cards gives all the necessary information to the workers regarding time and rates and laso obtains proper return for the preparation of cost and time records.
(4) Shop disciplinarian : His duty is to see that the relation between the management and workers is healthy and he has to prevent unwanted things like strikes and lockouts. He also acts as a connecting link between the planning department and the executive department.

EXECUTIVE DEPARTMENT : The following foremen operate in the executive department:

(5) Gang boss : It is the duty of this foreman to make all the preliminary preparation of the work up to the time the material is set in on the machine.
(6) Speed Boss : This foreman comes in when the work actually begins. He has to see that proper speed is maintained by all the workers.
(7) Inspector : His duty is to see that the workers understand all the instructions given to them; he has to ensure that right quality and quantity of goods are produced. No product is allowed to be disposed off unless certified by this inspector.
(8) Repair Boss : The duty of this foreman is to do repairs. He has to take care of the machines and see that they are in good working conditions.

F.W. Taylor has developed a new philosophy of management. His major publications are (1) A piece rate system (2) shop Management (3) Art of cutting metals and (4) The principles of scientific mangement.

25.5 Concepts of Scientific Management

For the sake of convenience and clear understanding of the elements underlying the scientific management, a few important concepts are discussed below:

25.5.1 Mental Revolution

The idea of co-operation between workers and employer for maximising the output was foreign at that time. Hence Taylor advocated mental revolution. This is in fact, the foundation on which the scientific management rests. It signifies a thorough change in the mental outlook of both the management and workers. The workers should take interest in the work. They should accept the methods of work suggested by the management. The employer should not merely look at the workers as wage earners but as equal partners. Both the parties must realise that one can not prosper without the cooperation of the other. Taylor says that close co-operation is the essence of scientific management.

25.5.2 Motion Study

Common sense dictates that there can be several methods of doing a task of performing an operation. But the determination of the best way of performing an operation is possible by motion study. According to Frank Gilbreth, 'Motion study is the study of eliminating wastefulness resulting from unnecessary, ill-directed and inefficient motions. The aim of motion study is to find and perpetuate the least waste methods of labour.

This study is a prerequisite for establishing a standard task for the workers. Motion study helps to eliminate the fatigue which is caused due to unnecessary motions. Motion sudy aims at improving job. In trying to improve jobs, motion study analyses every job to do three things: (1) to completely get rid of as many human movements as possible (2) To shorten the movement that can not be eliminated and (3) to make the movement less tiring; there are five important tools of motion study and they are as follows:

(1) **Process charts :** There are many number of charts that the analyst can make use of while designing a job and to see the ways to improve it.
(2) **Principles of motion study :** Motion study is the technique of improving jobs. So the following principles are necessary : (a) Rules for laziness (b) Rules for keeping busy (c) Rules for reduction and (d) Rules for placing them.
(3) **Motion study questions :** Suggestive questions are important among the tools of motion study.
(4) **Micromotion study :** Micromotion study means taking moving picture of jobs and then running them slowly through a projector.
(5) **Therblig Analysis :** Therblig is a small part of a job which is too short to measure time with a stopwatch. A time study analysis involves the measurement of a job part by part.

25.5.3 Time Study

Time study may be defined as the art of observing and recording the time required to do each detailed element of an industrial operation. The work is the result of the effort of man and machine and by a careful analysis of every element that could be divided into so many fundamental operations. With the help of a stop watch, the time taken to perform each of the fundamental operations are added and the standard time is ascertained after allowing for the rest and certain unavoidable delays. Providing incentive to the workers to do their best after determining the standard task of time, is the next aspect of time study. The next problem is to see that each worker works to the best of his ability. In order to achieve this, Taylor introduced the differential piece rate system.

CHECK YOUR PROGRESS-2

What is Time study-?

25.5.4 Fatigue Study

Ogden defines it as diminution of the capacity for work which follows excess of work or lack of rest and which is recognised on the subjective side by a characteristic sensation of malaise. It may be noted that fatigue is not over work; it is a safety device which prevents over-work. Under this study, it will be found out how long a period of rest should be, and what intervals of rest should be given. Fatigue study is meant to prevent any sweating of labour and at the same time to increase the workman's productivity.

25.5.5 Monotony

Closely connected with fatigue this has been defined as a 'Wearisome Uniformity'. Here, however, the psychological factor counts more. The tending of machines working with bewildering rapidity must be monotonus. With a repetition of certain tasks one becomes 'bored' uninterested and in other ways manifests a lessening desire to continue the performance or one may feel tiredness acccompanied by a desire to do something else for a change. Period of change of tasks has been adopted in some cases with good results.

25.5.6 Tool Study

No worker can perform his task efficiently unless the tools and equipment which he uses are good. Uniformity and standardisation of units produced cannot be ensured unless the tools themselves are standardised. For every job, there is a proper tool and it is the duty of management to make investigations in order to find out which tools will do the job well. Taylor advocated the setting up of a tool room under the charge of an expert who knows how the tools work. Thus, he will issue from the room the well conditioned tools which are marked as the best for a partcular job under the expert supervision.

25.6 Elements of Scientific Management.

Having considered the means of scientific management, now we proceed to discuss its elements. They include:

i) Determination of the task.
ii) Scientific Investigation
iii) Standardisation of tools and materials
iv) Improvements in the method of work
v) Proper selection and training of workers
vi) Modification of organisation

25.6.1 Determination of task

Under scientific management, the task or days work for an average worker under certain definite conditions is determined by the management. Care has to be taken to see that the task set should not be higher than the capacity of an average worker or below his capacity.

This increases the efficiency of worker and helps him to earn more.

25.6.2 Scientific Investigation

It is necessary to undertake a systematically organised enquiry of all factors relating to work and then perform the work according to the results indicated. It is a means for attaining a higher degree of excellence in all branches of management.

25.6.3 Standardisation of tools and Materials

Standardisation is to bring or to make of an established standard size, weight, quality, strength or the like of any thing. As a result of tool study and study of materials required, the planning department will determine the best tools and materials to be used for a particular type of work. So standardisation of tools and materials reduces the wastage, improves the quality of the product, maximises the output and reduces the cost.

25.6.4 Improvements in the method of work

The output of man and machine can be increased greatly by improving the conditions and methods of work by applying the scientific management. Improvements in the methods of work involve the standardization of equipment, increasing the speed and maintaining good condition of work and materials.

25.6.5 Proper selection and Training of Workers

Proper selection of workers would lead to increase in the efficiency. If the management wants to improve the method of work, it must select proper workmen and training should given to the selected Workmen. This increases the efficiency of the workers and helps them to earn more.

25.6.6 Functionlization of Organisation

As pointed out earlier, Taylor suggested the introduction of functional foremanship. According to this, the two functions of planning and execution are developed. The planning room issues necessary directions to the workers. Shortening of the working-hours, increasing the profit of management and reducing prices to consumers are the resultant effects of functinalisation of organisation.

25.7 CRITICISM

25.7.1 Introduction :

Under modern conditions, scientific management in its original form has been put in to cold storage. Thus Taylorism is a dead cult now.The use of the term scientific management is very inappropriate and has been subjected to serve criticism at the hands of opponents. Generally, the criticism came from (1) Employers (2) Workers and (3) Others.

25.7.2 Employers Objections

These are: (a) Scientific management requires a huge capital investiment. (b) It involves heavy expenditure because it has to conduct research in time study, motion study etc; (c) In times of depression, the maintenance of the entire paraphernalia of scientific management is a heavy burden. (d) A sudden change is necessitated by the introduction of scientific management, Paralyses the existing arrangement of work. (e) Particularly on account of the employment of non producers' whose salaries add to the overhead charges. Hence, it is less practicable.

25.7.3 Workers' objections

There are: (a) The increase in their earning is not in porportion to the rate of increase in their efficiency. (b) Scientific management through sub division and standardization of processes destroys workers initiative. (c) It renders workers unemployed as a consequence of the adoption of labour saving devices both in machinery and in arragement of work. (d) Scientific management speeds up the workers and this would affect their helth. This fear is due to the lack of proper understanding of the principles of scientific management.

25.7.4 Labour leaders Criticism to scientific management

It lowers the position of trade unions as the wages and working conditions are decided by the management on the basis of scientific analysis and the trade unions have no role in this matter.

25.7.5 Others' Criticism

Scientific management has been critised by some others from theoretical point of view:

(a) It focusses its attention only on problems of production management without touching the problems relating to marketing, finance etc;

(b) Too much emphasis is laid upon job analysis and situation in a manufacturing unit without making any attempt at integrating them into a full job.

(c) Scientific management is founded on certain pessimistic assumptions about human nature.

(d) Psychologists suggest that scientific management should aim at attaining maximum efficiency as measured not in terms of individual workersbut in terms or groups.

(e) Scientific management adopts mechanical approach towards the labour. Workers work like cogs in a machine without any opportunity to think about their jobs and methods of work.

25.7.6 Conclusion

We have examined the above criticism raised against scientific management. In recent years much of the critism has been overcome by the wiser application of the non-rigid methods of Taylorism, by the inculsion of the principles and methods of industrial Psychology, and by a better understanding of their functions and interrelations by labour and management.

On both sides, there is a craving for harmony and mutual understanding. And it has also been realised that collective bargaining, participative management and other schemes as a part of Scientific Management will assure the improvement in industrial relations. A better understanding of human factor in organisation will make scientific management really scientific. Productivity and satisfaction must go together in a really scientifically managed unit. Scientific management as a principle is good. The spirit behind it is to manage things rationally.

22.8 SUMMING UP

Scientific management solves many of the business problems especially managerial problems. This is nothing but application of science to the management scientific management combines the interests of management and employees. F.W. Taylor has very well described the philosophy of scientific management. Taylor has sponsored a functional foremen approach for the completion of the work. In course of the study of scientific management, various concerns like mental revolution, motion study, line study, fatigue study etc are described. This unit also extends its scope to the other areas like determination of work, scientific investigation, standardisation of tools and materials selection and training of workers, functionalisation of organisation etc.

25.9 CHECK YOUR PROGRESS : MODEL ANSWERS

1. F.W. Taylor defines the Scientific Management as an art of knowing exactly what you want the workers to do and seeing that they do it in the best and cheapest way.
2. It is an art of observing and recording the time required to do each detailed element of an industrial operation.

25.10 MODEL EXAMINATION QUESTIONS

A) EASSY QUESTIONS:

1. Give a brief account of the evolution of scientific management thought.
2. Explain the main elements of scientific management.
3. What is scientific management? Why was it opposed?
4. Describe the merits and defects of scientific management.

B) SHORT QUESTIONS.

5. What is functional foremanship?
6. Define motion study.
7. What is scientific management or Taylotism?
8. What is standardisation?
9. What is Fatigue Study?

25.11 RECOMMENDED BOOKS

1. Bushan Y.K. : Fundamentals of Business Organisations and Management. Sultan Chand and Sons, Delhi. 1.73 pp 4,11 to 4.32,
2. Drucker : The Practice of Management, Allied

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3. **Reddy P.N. and Gulshan s.s** : Principles of Business Organisation and Management. Eurasia Publishing House (P) Ltd. New Delhi 1981.
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5. **Shukla M.C.** : Business Organisation and Management. S.Chand & Co., (P) Ltd., New Delhi
6. **Singh B.P. and Chobra T.N.** : Fundamentals of Business Organisation, Kitab Mahal, Allahabad 1981.
7. **Taylor F.W.** : The Principlesof Scientific Management.

27.12 GLOSSARY

Economic Stability	:	Economy being in equilibruim. free from fluctuations
Fatigue study	:	Study of the diminution of the capacity for work which follows excess of work or lack of rest.
Micromotion Study	:	Taking moving pictures of jobs and then running them slowly through a projector
Monotony	:	Closely connected with fatigue but defined as wearisomeuniformity
Motion Study	:	Study of eliminating wasteful-ness resulting from unnecessary, ill-directed and insufficient motions.
Obsolete	:	Out of date
Productivity	:	Production per unit of factor input
Scientific management	:	The application of science to management. It implies that the methods of scientific eqguiry, analysis and summary can be applied to the activites of managers.
Scientific Investigation	:	A systematically organised enquiry of all factors relating to work.
Simplification	:	Making production process less complex
Standardisation	:	To bring to or make of an established standard size, weight, quality, strength of the like of any thing.
Therblig analysis	:	A time study analysis involving the measurement of a job part by a stop watch.
Time study	:	Art of observing and recording the time required to do each detailed element of an industrial operation.
Tool Study	:	An investigation into the appropriateness of the tools to be used for doing a job.

UNIT - 26: RATIONALISATION

Contents

26.0 AIMS AND OBJECTIVES

This unit aims at describing the concept and scope of Rationalisation. On completion of this unit, you should be able to:

- explain the meaning of Rationalisation
- distinguish between Rationalisation, Scientific Management and Combination.
- Mention the objections to Rationalisation.

26.1 INTRODUCTION

Immediately after the First World war,the economy of Germany was a shambles. The revival of her economy needed drastic measures. Such drastic measures taken by Germany to reorganise her industries came to be known as Rationalisation. The rationalisation movement was a complete success in Germany and the result achieved there was nothing short of a miracle. It attracted the attention and admirationof several other nations. Many other countries such as Great Britain followed suit Japan owes its industrial strength to the rationalisation movement.

26.2 Meaning, Definition and Scope of Rationalisation

The term 'Rationalisation' was derived from 'Rationalisierung, a German word. Rationalisation is a conscious attempt to eliminate waste and ineffeciency, Scientifically by some sort of joint action taken by all the firms operating within one industry. The scope of rationalisation is very wide. It is not possible to compress all the implications of the term within the boundaries of any rigid definition. Various authors have defined it in various ways.

Prof. E.A.G. Robinson defined Rationalisation as "the reorganisation of relationship between the firms and an industry". Robinson stresses the industrywise application of rationalisation. According to Sargant Florence, "Rationalisation is a movement to eliminate waste and inefficiency scientifically and logically by some sort of Joint Action between all the firms within one industry". This definition reveals the following features of rationalisation.

i. It is designed primarily to eliminate waste and inefficiency in industry.
ii. It involves application of scientific techniques andlogicalthinking.
iii. It requires some kind of joint and cooperative actidn.

McGregor defines rationalisation as "the right organisation of industry considered as a type of Government, the producers being so related as to enable such policies to be applied as work specialisation, non-destructive elimination of the weak and control over the entrance of new establishments". This definition implies the formation of combination in the industry and confining production only to existing efficient units.

The world Economic Conference defined rationalisation as the "methods and techniques of organisation designed to secure the minimum waste of either effort or materials. It includes the scientific organisation of labour, simplification of processes and improvements in the system of transport and marketing" Thus,

a. rationalisation, in general is a reform tending to replace habitual antiquated practices by means or methods based on systmatic reasoning.
b. In a wider sense, it is a reform which takes a group of business undertakings as a unit and tends to reduce waste and loss due to unbrideldcompetition by concerned action based on systematic reasoning.
c. In the widest sense,it is a reform tending to use means and methods based on systematic reasoning to the collective activities of the large economic and social groups.

Check your Progress - 1

Define Rationalisation as given by E.A.G. Robinson.

26.3 Factors Leading to Rationalisation

The need for joint action on the part of all the firms in an industry arose because of the following causes of wastage, inefficiency and low productivity.

26.3.1 Scramble for Scarce Resources

Generally resources are limited. Due to lack of planning,the competitive units scramble for the limited and scarce resources. The solution to the problem is rationalisation ensuring a joint and planned utilisation of the available resources.

26.3.2 Idle Plant Capacity

Any economic activity is characterised by the business cycle consisting of booms and depression. During periods of prosperity,the plant capacity is increased considerably. This has its impact on the industry during periods of depression. During such periods,the demand declines considerably. The industrial units reduce the production also. Hence the additional capacity idle results in high cost of production. Therefore, there is need for scrapping the idle plant capacity and this can be done onlythroughjoint action on the part of all the firms in an industry.

26.3.3 Unnecessary Varities

The undue competition among the producers results in producing more varieties of the same product. This is because of two reasons. One is the frequent change in the tastes and fashions of the consumers and the other is producers' craze for catching the market. New producers enter the market very frequently and the existing ones are to change their products. By and by, the varieties become so large in number that every producer produces particular varieties become so large in number that every producer produces 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 minimised.

Rationalisation is an attempt to eliminate the unnecessary varieties by a joint action of the competing films. the products are standardised in terms of quality, size, design and other characteristics so that large-Scale production can be carried out.

26.3.4 Obsolete Machinery

Obsolete machinery and equipment create many problems. They cause greater strain to the workers and involve high cost of maintenance and repairs and higher operative expenses. The efficiency and productivity of labour also declines. Thus the need for rationalisation arises in order to replace obsolete machinery by upto date machinery so that higher productivity at lower cost is achieved.

26.4 Steps in Rationalisation

Rationalisation involves a number of steps which can be discussed under the following heads:

1. Technological
2. Organisational
3. Financial
4. Social

26.4.1 TCHNOLOGICAL

Rationalisation is concerned with industrial engineering involving various processes like standardisation, simplification, mechanisation, intensification, specialisation and functionalisation.

Standardisation: This involves fixing of certain standatds of size, process, quality of product in order to reduce the varietyof types. Varied and haphazard standards are replaced by standards based on research, experimentation and analysis. It eliminates waste of efforts and materials, It leads to reduced cost of production and distribution,Standardisation calls for continuous search for new standards.

Simplification : Simplification involves making production programme and process less complex. It aims to produce only limited types of products and to eliminate redundancy. It results in greater productivity and efficiencyandless waste and easier acquisition of proficiency by operatives, locking up of lesser capital in materials and spare parts, simple costing systems and easier effect of seasonal variation. Retailer is relieved of the trouble of having more stock.

Mechanisation: This involves introduction reliance on machines helps the manufacturer to improve efficiency of the unit and to reduce cost of production. But rationalisation does not always necessary mean more machines because efficiency of the unit can also be increased by employing more labour. Especially in an underdeveloped economy with largescale unemployment, rationalisation should be based on labour absorbing machines not on labour saving machines.

Intensification: This involves making the best use of the existing industrial mechinery as a greater speed. This results in the increase in the productivity of the workers.

Specialisation: This follows from standardisation of production. When production is concentrated over a limited number of varieties and if 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.

Functionalisation: This means application of specialisation to supervision and management. In other words, it means the introduction of scientific management in an industrial unit.

Industrial Research : Rationalisation relies heavily on programmes of industrial research for choosing the most economical process of production. Research enables the quality of goods to be improved.

Check Your Progress - 2

What is meant by functionalisation?

26.4.2 Organisational

Rationalisation implies taking of the following organisational steps.

a. **Amalgamation** is a merger of small or weak units with big and efficient units. It also involves modernisation through self-financing implying a conservative dividend policy and a liberal provision for maintenance and renewal of reserves.

b. **Elimination** of cut-throat competition in industry.

c. **Setting up of joint authority** for taking united action on various matters such as removal of excess capacity, planned utilisation of scarce resources, etc.,

d. **Adjusting** the total volume of production to probable total volume of consumption in order to reduce the economic disequilibrium and to regulate prices.

e. **Radical change** in the method of management in various firms of an industry. This implies application of the principle of scientific management. The systematic attempt at raising the efficiency of management will naturally lead to higher productivity which is the goal of rationalisation.

26.4.3 Financial

Rationalisation implies financial reorganisation for carrying out schemes connected with the technical aspects of rationalisation. Various units of the industry should be neither over capitalised nor under-capitalised. Rationalisation also implies allocation of finance for expansion or reorganisation of old units and the establishment of new plants.

26.4.4 Social

Rationalisation is concerned not merely with the rise in productivity; it is equally concerned with the prosperity of all sections of society. The benefits of rationlisation should be enjoyed by all the parties. The producers should be able to reduce cost and increase profits. The workers should be benefitted by the increased earnings, smaller work load and better amenities. The consumer should get goods of better quality at cheaper prices.

26.5 AUTOMATION

The term 'Automation' has been defined differently by different people. Automation can be described as an advanced technology characterised by specific devices of communication and control in self regulation without human intervention. Some people consider it synonymous with rationalisation. But it can be considered as a part of rationalisation only if it is introduced in an entire industry.Automation has a great impact on the productivity of industrial units and standard of living of the people. It helps in creating new products and dveloping a new industrial culture. Automation is the next stage after mechnaisation. The concept of self-regulation of machines is the distinguishing feature between mechanisation and automation. In case of automatic machinery, the machine is able to sense, feel, detect and correct errors and faults while they occur.

Automation involves the following three steps :

Integration : This means linking together conventionallyseparate manufacturing opertations into lines of continuous production. Mechanicaltransfer devices are used for linking various production processes. Materials are fed by machines at one end and are processed and transformedinto finished products at the other end.

Feed bank control : There is automatic control which receives information from the various machines automatically. It corrects deviations or errors at the appropriate time.

Computer : In an automated plant, computers are used to process the increasing range of technical and commercial information for decision making.

Check your progress - 3

What is meant by Automation ?

26.6 DISTINCTION BETWEEN RATIONALISATION AND SCIENTIFIC MANAGEMENT

Rationalisation and Scientific Management are similar in certain respects. Both aim at increasing efficiency and productivity and bringing about maximum utilisation of resources of all kinds. Both seek to introduce scientific methods of organisation and work replacing outdated and unsystematic methods.

However there are the points of distinction as follows :

26.6.1 Scope : Rationalisation has wider scope than scientific management. Scientific management can be introduced by individual firm to increase its efficiency. Rationalisation, on the other hand, concerns itself with the problems of industry as a whole and not of individual units. Rationalisation cannot be introduced in individual units. Rationalisation cannot be introduced in individual units alone.

26.6.2 Steps : the steps taken under rationalisation are different from those follwed under Scientific Management. They are as follows :

a) Combinations : Rationalisation aims to end rivalries among concerns and to settle the problem of inefficiency through amalgamations and mergers. The weak and inefficient units merge with strong ones in the interest of efficiency of the industry as a whole. Scientific management is in no way coperned with combination. Its only aim is to improve the efficiency of a particular unit. It tries to achieve its objective by developing a spirit of cooperation between the employers and employees within a particular unit.

b) Avoidance of Scramble for Resources : It is not a measure of scientific management to arrange for the proper distribution of resource among various concerns in any industry, while Rationlisation aims to allocated the scarce resources among the units of the industry through a joint authority set-up by the units or by the Government. Any concern following Scientific Management does not ensure the fair allocation of scarce resources. At best it can make proper use of its own share of resources.

c) Removal of Idle Capacity : As scientific management is confined to a particular unit of plant, it does not seek to tackle the problem of adjusting the plant capacity to demand. But rationalisation aims to remove the idle capacity by closing down the inefficient plants through the joint authority set up for the purpose.

d) Standardisation of varieties : One important measure of rationalisation is the standardisation ofvarieties and the elimination of unnecessary varieties. Theproductionof each variety retained will rise and the cost of its production will be brought down. Scientific Management concerns itself with the efficient production of whatever varieties are already being produced without eliminating the unnecessary ones.

26.6.3. Coverage : rationalisation has a wider coverage and a broader approach. It is concerned, with regulation of production, marketing, finance, advertising, transport on wide scale. Scientific management is concerned with only efficient management of production. It organises labour and productive processes on scientific and systematic lines for the purpose. It is not concerned with the problems of marketing, finance and transport.

26.6.4 Mechanism : There is no fixed and predetermined mechanisms for Rationalisation. There is no particular order in which the measures are taken under rationalisation, on the other hand,Scientific Management has a well defined and well set mechanism of operation.

26.6.5 Social objectives : Rationalisation is associated with certain social objective such as raising the remuneration of workers, reducing the prices of the products for the benefit of consumers. improving the quality of the products, and raising the standard of living of the members of the society. Scientific management is not concerned with social objectives. It aims only at more efficient management of the existing firms through the use of scientific methods of research and experimentation.

Scientific management cannot control the relations of the firm with the outside world as rationalisation does. This does not mean that both are mutually exclusive. Rationalisation includes scientific management of production and goes a step further to deal with the other problems arising in the course of managing an industry and its component units.

26.7 DISTINCTION BETWEEN RATIONALISATION AND COMBINATION

As rationalisation implies some kind of joint action by the firms of an industry under a joint authority, it is treated by some as a form of combination. But there are differences between them as under :

26.7.1 Scope : Rationalisation covers all the units of a particular industry while combination need not necessarily cover the entire industry and it can be formed by a few firms in an industry. While rationalisation includes combination besides standardisation, specialisation and scientific management, combination does not embrace the other measures.

26.7.2 Objective : Rationalisation is associated with economic human and social objectives. Its general purpose is formation of human welfare. Combination aims to form monopolies checking unnecessary competition which is anti-social.

26.7.3 Origin : Awareness of the need for removing the maladjustments improving the efficiency of any industry led to rationalisation. But the combination movement originated from the attempts of industrial units at eliminating acute competition and establishment of monopolies for their gains.

26.8 BENEFITS OF RATIONALISATION

Rationalisation brings definite economies and advantages and is considered as the key to higher productivity and social welfare. The chief merits of rationalisation are as follows :

26.8.1 To the Producers

a) Increased Profit : Rationalisation reduces the cost of production. Under rationalisation small and weak firms disappear and strong ones become stronger. It aims to cover some uneconomic units into profitable ones.

b) Economy in production : Rationlisation results in economy in production and decline in cost of production.

c) Industrial Cooperation : Rationalisation achieves a degree of cooperation among the various rivals in the industry in doing away with cut-throat competition and replacing competition with combintion.

d) Economic Stabiltity : As rationalisation aims to enable the industry ready its equilibrium between demand and production, stability is achieved in the industry.

e) Promotion of Industrial Research : Rationalisation leads to pooling of research and scientific knowledge. Such pooling promotes further research to the advantage of all producers.

f) Economies of Specialisation and mechanisation : Rationalisation involves specilisation. Each unit will undertake the production of that particular variety for which it is best suited. This will enlarge the scale of production and hence economies of scale will accrue.

This will enlarge the scale of production and hence economies of scale will accrue.

26.8.2 To the workers

a) Higher Remuneration : Rationalisation results in higher productivity by eliminating wastage and inefficiency and hence costs are reduced. The benefit of such reduction in cost must be passed on to the workers in the form of higher remuneration.

b) Improving Efficiency : Rationalisation increase labour productivity, while seeking to eliminate waste of human effort.

c) Greater Security : Though in the short run, rationalisation may result in some unemployment, in the long run it may increase the employment opportunity due to the increase in demand for the products of the rationalised industry.

26.8.3 To the consumers

a) Cheaper Goods : One of the basic objectives of rationalisation is to provide cheaper goods to the consumers. This is possible because it brings down the cost of production.

b) Improved Quality of Products : Specialisation in production and the promotion of Industrial research jointly will lead to production of goods of better quality.

c) Convenience of choice : As rationalisation involves standardisation of products it results in fewer products. Hence the consumer is relieved of the botheration of making choice among a large number of varieties.

d) Better standards of living : By making available cheap, attractive and durable products rationalisation helps in raising the standard of living of consumers. The consumers are enabled to buy a larger number of standardised products with the same income.

26.8.4 To the Nation

a) Higher National Income : By setting right the maladjustements in the economy, it makes the economy progressive and helps it in enjoying higher levels of national income.

b) proper allocation of resources : Rationalisation seeks to allocate tha available resources of a nation over different uses in such a way that there is neither Wastage of resources nor scarcity.

c) Better Export Potential : When cost of production is reduced in rationlisation, the products become more competitive in the international market. Hence the rationalised industry gains in the export market.

d) National prosperity : All the above advantages like cheap goods of high quality, higher wages to workers, reputation in interational markets, etc., will result in the prosperity of the nation as a whole.

26.9 OBJECTIONS TO RATIONALISATION

Though rationalisation has all the above advantages, it is not free from criticism. The following criticism emanates from the employers and the employees.

26.9.1 Employment Criticism

a) Heavy Capital Investment : Employers hesitate to make huge investment in machines and other schemes of rationalisation. They fear they may not be able to make such investment regularly and such investment may not fetch adequate returns. During depression such investments have first to be written off.

b) Shortage of Finance : Shortage of finance is one stumbling block for the introduction of rationalisation.

c) Fear of Nationalisation : Employers' fear of nationalisation of the rationalised industry by the Government also discourages them in making investment in schemes of rationalisation.

d) Fear of obsolescence : As there is no limit for investments and discoveries resulting from continuous research, any scheme of rationalisation introduced at a huge cost may soon become obsolete. In that case,the huge investment made becomes a waste.

e) Fear of demand for higher wages : As workers may demand a higher share in the increase of productivity, the employers may not actually reap the benefit of any scheme of rationalisation.

However these apprehensions are based on the thinking of the employers that rationalisation is synonymous with mechanisation. But rationalisation has a wider scope aiming at reducing wastage and minimising cost. If the employers understand this, they may not raise such objections.

26.9.2 Workers' criticism

Workers are vociforous in their criticism against rationalisation. Their criticism is :

a) Fear of unemployment : The various measures taken under rationalisation such as mechanisation, closure of less efficient and unproductive units and curtailing production to the level of demand involve retrenchement of workers which is strongly objected by workers. However unemployment is the difficultyonly in the short run. In the long run, this problem may be solved in due course as decline in prices will push up the demand of the products and more production implies more employment.

b) Fear of increase in workload : Workers are afriad that they may be required to work more on the introduction of a scheme of rationalisation. They consider rationalisation as a device to extract more work. They fear more strain and fatigue due to rationalisation. However studies in work environment, fatigue studies, etc., by the engineers and psychologists will remove their fear.

c) Fear of Exploitation : Workers feel that the managements exploit them by offering an insignificant share of the benefits of rationalisation to them. Rise in wages is not proportionate to rise in productivity.

d) Fear of Losing importance : Rationalisation aims to give more importance to machines and to reduce the importance of labour. However, rationalisation also increases the importance of man because labour should improve from unskilled to skilled in any scheme of rationalisation.

26.9.3 General Objections

a) Rise in monopoly : Since joint action on matters affecting units constituting an industry is an important aspect of rationalisation, it results in monopolistic combination .

b) Evils of Big Business : In rationalisation, units tend to expand. In the process they may expand to an unwieldy size. Therefore the drawbacks of such big size and monopolies may creep in.

c) Destruction of cottage and small scale industries : Formation of monopolies and big business, which is the corollary of rationalisation destroys cottage and small scale industries giving rise to unemployment of large number of poeple. It also destroys the creative and artistic skill inherent in such industries.

26.10 RATIONALISATION IN INDIA

There have been very little attempts to rationalise Indian Industries. There have been a number of difficulties in the introduction of rationalisation. They are :

1) Control of Indian industries by the Managing agents for a long time. They are not inclined towards cooperation which is essential for rationalisation.

2) Indian industrialists interpret rationalisation only in terms of mechanisation and automation. Therefore there has been a strong opposition from labour for rationalisation.

3) Shortage of capital is another difficulty in introducing rationalisation.

4) The scope for technical improvement, scientific managment and the introduction of labour saving devices is limited in India. Labour is cheap and abundant and hence the problem is not so much of saving human labour as of providing employment to large numbers.

There have been sporadic attempts to introduce rationalisation. However, it has been the policy of the Government to encourage rationalisation. It has taken the following steps for the purpose.

1) The Industries (Development and Regulation) Act, passed in 1951, provides for the foramtion of Development councils to regulate targets and coordinate the production. The Act also aims at improving the efficiency of the industries, improving the quality, reducing the cost and promoting better marketing.

2) The Government has been providing financial assistance to industries for modernising the equipment through National Industrial Development Corporation and Industrial Finance Corporation.

3) Government set up Indian Standards Institute in 1946 with headquarters in New Delhi. It helps simplification as well as specialisation resulting in large scale production of goods at lower price.

4) Apart from above, the Government has established a number of research institutes and laboratories for promoting industrial research.

26.11 SUMMING UP

Rationalisation

After the Ist World War, the economy of Germany was in a shaby position, then their organisation of industries came up and the drastic changes were undertaken in the name of Rationalisation. The changes brought better results and attracted the World's attention. The scope of the Rationalisation is very wide and this is intended mainly for the optimum utilisation of scarce resources and Rationalisation is for reduction of inefficiency.

Rationalisation is concerned with the technical,organisational financial and social aspects. Automation as a *part* of Rationalisation will have an impact in productivity. Rationalisation has a close affinity with the Scientific management and industrial combinations. Rationalisation benefits are to the producers, workers, consumers and finally to the national economy.

Despite its merits, Rationalisaton is subjected to criticism from the employers, workers and the public in general. The Rationalisation has yet to make its impact on Indian industries.

26.12 CHECK YOUR PROGRESS : MODEL ANSWERS

1. It is the reorganisation of relationships between the firms and industry.
2. It means the application of specialisation to supervision and managment, it is nothing but introduction of Scientific Management.
3. It is an advanced technology characterised by specific devices of communication and control in self regulation without human intervention.

26.13 MODEL EXAMINATION QUESTIONS

A) ESSAY QUESTIONS :

1. Explain the factors leading to Rationalisation.
2. Explain the steps in Rationalisation.
3. What are the benefits of Rationalisation?
4. What is the criticism against Rationlisation?
5. How do you ally the fear of unemployement due to Rationalisation?
6. What is the scope for Rationlising Indian Industries?

B) SHORT QUESTIONS :

7. What is meant by Rationalisation?
8. What is meant by simplification?
9. What is meant by Functionalisation?
10. What is meant by Automation?

26.14 RECOMMENDED BOOKS

1. **Bushan Y.K.** : Fundamentals of Business Organisation and Management Sultan Chand and Sons, 1973 New Delhi.
2. **Drucker /** : The Practice of Management, Allied Publishers (P) Limited, Bombay.
3. **Reddy P.N. and Gulshan s.s.** : Principles of Business Organisation and Management. Eurasia Publishing House (P) Ltd. New Delhi. 1981.
4. **Saksena S.C.** : Business Administration and Management, Sahitya Bhavan, Agra. 1981.
5. **Shukla M.C.** : Business Organisation and Management, S. Chand & Co., (P) Ltd., New Delhi.
6. **Singh B.P. and Chobra T.N.** : Fundamentals of Business Organisation, Kitab Mahal, Allahabad. 1981.
7. **Taylor F.W.** : The Principles of Scientific Management.

26.15 GLOSSARY

Automation : Self-regulation of machines without human intervention

Combination	: Two or more units combining together
Feed-Back Control	: Automatic receipt of information from various machine and correcting deviations
Functionalisation	: Application of specialisation to supervision and management
Idle Plant Capacity	: The profit of the plant capacity remaining unutilised
Integration	: Linking together the separate manufacturing operations into line of continuous production
Intensification	: Making the best use of the existing industrial machinery at a greater speed
Mechanisation	: Introducing machine
Mental Revolution	: A thorough change in the mental outlook of both management and workers.
Nationalisation	: Government take over of private business of industrial units
Rationalisation	: Reorganisation of relationship between the firms and an industry so as to eliminate waste and inefficiency.
Leadership	: The art of influencing others in the achievement of group goals.
Management	: The art of getting things done through others.
Management Cycle	: The various managerial activities starting from planning, organising, coordinating, communicating and controlling.
Operating Management	: Lower level management involving doing activity
Organising	: The process of delegation, decentralisation and departmentation and creating a structure to achieve predetermined goals.
Reporting	: The process of providing the required information as demanded by the various controls set up in the organisation.
Staffing	: Activities concerned with the selection of personnel, placement, training and a praisal.

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FACULTY OF COMMERCE

B.Com. II YEAR (3 YDC) EXAMINATION
MODEL QUESTION PAPER
GROUP-I : PAPER-I
BUSINESS ORGANISATION & MANAGEMENT

TIME-3 hours

Max Marks - 100
Min. Marks - 35

PART-A : Essay Questions

(Marks 4 × 15 = 60)

Answer any Four of the following

1. Explain the various stages in the evolution of industries.
2. What are the privilages of a private limited company?
3. Explain the features of partnership.
4. State the need for cooperation and the principles of cooperation.
5. What is the need for state regulation of business? Explain in this context, the role of Industrial Development and Regulation Act?
6. How do business firms raise their working capital?
7. What is an organised market? What characteristics should commodities possess if they wre to be dealt in an organised market?
8. What are the objections to rationalisation from employers and workers?

PART-B : Short Questions

(Marks 5 × 8 = 40)

Answer any Five of the following.

1. Classify the Industry?
2. How is company organisation superior to partnership firm?
3. What is an extra ordinary general meeting? What type of business is transacts in that meeting?
4. How can a cooperative society be formed?
5. What are the devices of trade promotion?
6. What are the determinants of fixed capital?
7. Can middle man be eliminated?
8. State the need for state Regulation?
9. Distinguish between automation and rationalisation
10. Answer any two of the following :
    a) Scienctific Management
    b) Memorandum of Association
    c) Whole Saler
    d) Promotion

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UNDER GRADUATE COURSES-II YEAR
SUBJECT : COMMERCE
ASSIGNMENT-I

N.B.

1. Do not copy the answer directly from any of the books
2. As far as possible try to answer the questions independently in your own words
3. If it is necessary to quote from any source, give the correct reference
4. Use your own foolscap pages for writing the assignment
5. Leave sufficient margin for the comments of the evaluator.
6. Completion of this assignment normally should not take more than two hours time.

PART - A

1. What steps do you take to prevent future disputes with the partners in a newly started partnership concern?
2. What are the various methods used in business enterprises to raise their working capital needs?
3. What are the features of Joint Stock Companies?

PART-B

Answer these questions in about 15 lines each

1. Explain the Scalar Principle?
2. Can management be considered as profession?
3. How is rationalisation different from scientific management?

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UNDER GRADUATE COURSES-II YEAR
SUBJECT : COMMERCE
ASSIGNMENT-I

N.B.
1. Do not copy the answer directly from any of the books
2. As far as possible try to answer the questions independently in your own words
3. If it is necessary to quote from any source, give the correct reference
4. Use your own foolscap pages for writing the assignment
5. Leave sufficient margin for the comments of the evaluator.
6. Completion of this assignment normally should not take more than two hours time.

PART - A

1. Explain the unique features of cooperatives and State how its management differes from that of a joint stock company?
2. Explain the different ways of ensuring public Accountability of public enterprises?
3. How is both over capitalisation and under capitalisation/

PART-B

Answer these questions in about 15 lines each
1. Explain the importance of capital structure devision?
2. How is Industrial policy different from Indutrial Licensing policy?
3. What are the advantages of Departmental stores?

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UNDER GRADUATE COURSES-II YEAR
SUBJECT : COMMERCE
ASSIGNMENT-I

N.B.
1. Do not copy the answer directly from any of the books
2. As far as possible try to answer the questions independently in your own words
3. If it is necessary/to quote from any source, give the correct reference
4. Use your own foolscap pages for writing the assignment
5. Leave sufficient margin for the comments of the evaluator.
6. Completion of this assignment normally should not take more than two hours time.

PART - A

Answer these questions in about 30 lines each.
1. Distinguish between Marketing and Selling?
2. Describe briefly the elements of scientific management?
3. State the basic objectives of industrial licensing and describe briefly the licensing procedure?

PART - B

Answer these questions in about 30 lines each.
1. What are advantages of Partnership firm?
2. What is the need for starting co-operatives?
3. What are the special features of handicrafts system?