



**Block**

# 2

## **BUSINESS ENTERPRISES**

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## PROGRAMME DESIGN COMMITTEE B.COM (CBCS)

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Prof. Madhu Tyagi Director, SOMS, IGNOU	Prof. D.P.S. Verma (Retd.) Department of Commerce University of Delhi, Delhi	Prof. R. K. Grover (Retd.) School of Management Studies IGNOU
Prof. R.P. Hooda Former Vice-Chancellor MD University, Rohtak	Prof. K.V. Bhanumurthy (Retd.) Department of Commerce University of Delhi, Delhi	<b>Faculty Members SOMS, IGNOU</b>
Prof. B. R. Ananthan Former Vice-Chancellor Rani Chennamma University Belgaon, Karnataka	Prof. Kavita Sharma Department of Commerce University of Delhi, Delhi	Prof. N V Narasimham Prof. Nawal Kishor Prof. M.S.S. Raju
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Prof. Purushotham Rao (Retd.) Department of Commerce Osmania University, Hyderabad	Prof. Debabrata Mitra Department of Commerce University of North Bengal, Darjeeling	Dr. Madhulika P Sarkar Dr. Anupriya Pandey

---

## COURSE DESIGN COMMITTEE

---

Prof. Madhu Tyagi Director SOMS, IGNOU	Prof. A.K. Singh Department of Commerce University of Delhi, Delhi	<b>Faculty Members SOMS, IGNOU</b>
Prof. D.K. Vaid (Retd.) NCERT Delhi	Prof. Vijay Kumar Shrotriya Department of Commerce University of Delhi, Delhi	Prof. N V Narasimham Prof. Nawal Kishor Prof. M.S.S. Raju
Prof. Bhanu Murthy (Retd.) Department of Commerce University of Delhi, Delhi	Dr. Rajendra Maheshwari (Retd.) Ramanujan College University of Delhi, Delhi	Dr. Sunil Kumar Dr. Subodh Kesharwani Dr. Rashmi Bansal Dr. Madhulika P Sarkar Dr. Anupriya Pandey

---

## COURSE PREPARATION TEAM

---

Prof. Nawal Kishor (Unit 8) <b>Business Organisation: ECO-01</b> (Unit-2, 3 and 17 Revised by Prof. Nawal Kishor)	Prof. Nawal Kishor (Editor & Course Coordinator)
Prof. P. K Ghosh (Retd.), University of Delhi, Delhi	Dr. Subodh Kesharwani (Editor & Course Coordinator)
Dr. Nafis Baig (Retd.), AMU, Aligarh, UP	
Dr. R.N Goyal (Retd.), Deshbandhu College University of Delhi, Delhi	

---

## MATERIAL PRODUCTION

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Mr. Y.N. Sharma Assistant Registrar (Publication) MPDD, IGNOU, New Delhi	Mr. Sudhir Kumar Section Officer (Pub.) MPDD, IGNOU, New Delhi
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## **BLOCK 2      BUSINESS ENTERPRISES**

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You have learnt foundation of Indian business covering introduction to business, technological innovation, social responsibility and emerging opportunities in business in Block 1. This Block 2 entitled Business Enterprises deal with the various forms of business organisation, Public enterprises and the importance of international business and recent trends, features and challenges of multinational corporation.

**Unit 5** explains various forms of business organisation and discusses the features, merits and limitations of each form.

**Unit 6** compares all forms of business organisation and analyses the factors affecting the choice of form of business organisation.

**Unit 7** explains the features, merits and limitations of various forms of organisation of public enterprises and analyses their suitability in given situations.

**Unit 8** discusses the importance of international business and features, trends and challenges of multinational corporation.



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# UNIT 5    FORMS OF BUSINESS                  ORGANISATION-I

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## Structure

- 5.0    Objectives
- 5.1    Introduction
- 5.2    Sole Trader Organisation
  - 5.2.1    Main Features
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  - 5.3.5    Joint Hindu Family Firm
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  - 5.5.3    Merits and Limitations
- 5.6    Let Us Sum Up
- 5.7    Key Words
- 5.8    Answers to Check Your Progress
- 5.9    Terminal Questions

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## 5.0    OBJECTIVES

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After studying this unit, you should be able to:

- describe the various forms of business organisations
- discuss the features of each form of business organisation
- explain the merits and limitations of each form of business organisation

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## 5.1    INTRODUCTION

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You must be knowing that any activity carried with profit motive is called business. Such activity may be an industrial activity, a trading activity or a service activity like banking, insurance, transportation, etc. Bringing various resources together to set up a business and putting them to work systematically is termed

as business organisation. The person who takes initiative to set up a business, provides the necessary funds and bears the risk involved is called the owner of the business. When the business is organised on small scale, it may be possible for one person to provide the funds and bear the risk. But when it is large, he may need others to join hands. Thus, business may be owned by an individual or a group of persons. When a business is owned and carried on by one person it is called ‘Sole Trader Organisation’. But when it is owned by a group of persons it may take the form of partnership firm, a company or a cooperative society. In this Unit, you will study in detail the features, classification, merits and limitations of these different forms of business organisations.

Look at Figure 5.1. It shows various forms of business organisation.

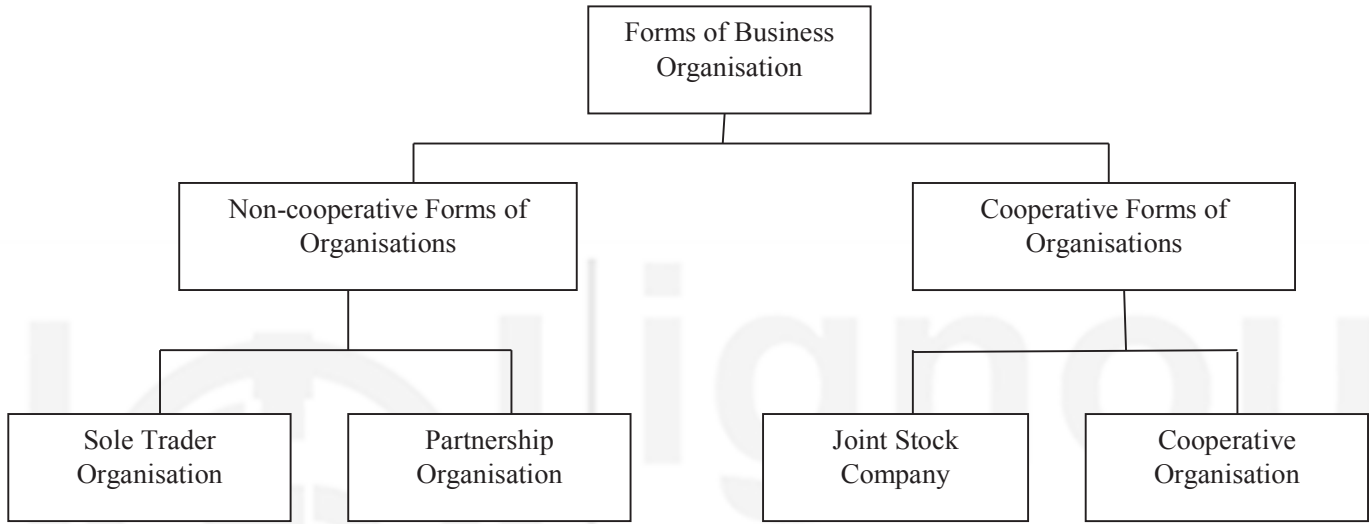


Fig. 5.1: Various Forms of Business Organisations

## 5.2 SOLE TRADER ORGANISATION

The sole trader organisation (also called proprietorship) is the oldest form of organisation and the most common form of organisation for small business even today. It is the simplest and easiest to form. What is required is that an individual decides about the type of business to be started and arranges the necessary capital. Required capital may be mobilised from his own savings, or may be borrowed from friends and relatives. The business may be carried either in a portion of his own residence or in a rented building. The person generally manages the business on his own. He may also take the help of his family members or employ some persons, if necessary. He can take the advice from others in running the business, but his own decision will be the final decision. Thus, the sole trader enjoys full control over the affairs of the firm. He enjoys all the profits earned by the business. So in case of loss, naturally, he has to bear the full brunt of it.

Thus, we can now define sole trader organisation as “one man’s business in which an individual produces independently with his own capital, skill and intelligence and is entitled to receive all the profits and assumes all the risks of ownership”. J.L. Hanson defines it as “a type of business unit where one person is solely responsible for providing the capital for bearing the risk of the enterprise and for the management of the business”. Under this form of business organisation, no distinction is made between the business concern and the proprietor. Likewise, the management rests with the same person.



### 5.2.1 Main Features

Based on the above discussion, we can list the main features of sole trader organisation as follows.

- 1) **One man ownership:** The ownership lies with one person only. There are no associates or partners. He invests his own money or borrows from the friends and relatives.
- 2) **No separation of ownership and management:** The owner himself manages the business. Therefore, the separation of ownership and management which is quite common in big business is not present in this form of organisation. Since the proprietor himself manages the business, he exercises a high degree of supervision and control in the working of his business.
- 3) **No separate entity:** The business does not have an entity separate from the owner. The proprietor and the business enterprise are one and the same.
- 4) **All profits to proprietor:** Since there are no partners, all the profits are enjoyed by the sole proprietor.
- 5) **Individual risk:** All losses in the business are borne by the proprietor himself.
- 6) **Unlimited liability:** The proprietor has an unlimited liability. This means that in case of loss even the personal property of the owner can be utilised for clearing the business obligations and debts.
- 7) **Less legal formalities:** To set up sole proprietorship, no legal formalities are required. Of course, there are some legal restrictions for the setting up of a particular type of business. For example, an individual cannot start a bank or an insurance company. But one can start a fruit stall or a cycle shop without much legal formalities. However, in some cases a licence may be required. For example, to start a restaurant, you need licence from municipal corporation

### 5.2.2 Merits and Limitations

You have learnt about the main features of the sole-trade business. In view of these features, this form of organisation has the following merits and limitations.

#### Merits

- 1) **Easy formation:** There are no legal formalities to be observed while starting this form of organisation. Therefore, its formation is very easy and simple. The expenditure involved in the process of formation is also negligible.
- 2) **Direct motivation:** As you know, all the profits and gains of the business are solely and exclusively pocketed by the sole proprietor. This motivates the proprietor to work hard and develop the business to get more and more profits. His involvement in the business is, therefore, complete and free.
- 3) **Full control:** The proprietor is the monarch of the business he owns. He manages the whole business and takes all decisions himself. In other words,



proprietor exercises full control over the functioning and working of the business.

- 4) **Quick decision:** The proprietor does not depend on others for decision making. Since there are no partners, he is not required to consult others. This enables the proprietor to take quick decisions on numerous matters concerning his business.
- 5) **Flexibility in operations:** Being a small organisation, it is easy to bring changes if situation so demands. In a large sized organisation to bring changes is difficult.
- 6) **Secrecy:** Since the whole business is handled by the proprietor, his business secrets are known to him only. He is not bound to publish his accounts. Therefore, the degree of secrecy is the highest in this form of organisation.
- 7) **Personal touch:** When the proprietor handles everything relating to the business himself, it is easy to maintain a personal rapport with the customers. He can easily know their tastes, likes and dislikes and adjust his operations accordingly. Similarly, in this form of organisation, employees, if any, work directly under the proprietor. So, it gives scope for the proprietor to maintain harmonious relations with the employees.
- 8) **Dissolution easy:** Since there are no co-owners or partners, there is no scope for the difference of opinion in the case of dissolution of business. The proprietor is free to withdraw from the business or to sell it at any time he wants. Because of ease in formation and withdrawal, proprietorship form is often used to test business ideas.

### Limitations

- 1) **Limited resources:** The capital and other resources of an individual are always limited. The sole trader has to mainly rely on his own money and earnings, or he can borrow, if necessary, from relatives and friends. Thus, the proprietor has a limited capacity to raise funds. This makes it difficult to plan any large scale expansion.
- 2) **Limited managerial capability:** In the modern business, knowledge and skills in various fields like production, finance, marketing, etc., are required. It is not possible for a single individual to possess expertise in all these areas. So, his decisions may not be balanced.
- 3) **Not suitable for large scale operation:** Since the resources of the sole trader are limited, it is suitable only for small business and not for large scale operations.
- 4) **Unlimited liability:** You know that the proprietor has an unlimited liability. In case of a loss, even his personal property and belongings can be utilised for clearing business obligations. Therefore, he cannot take much risk and is discouraged from expansion of his business.
- 5) **Less stability:** The continuity and stability of the business depends solely on one person. When the man dies, there is a likelihood of closure of the business.

- 6) **No check and control:** As the sole trader is the monarch of the business, no outsider can question him on his acts and deals. There are no checks and controls on the sole trader.
- 7) **Less scope for economies of scale:** Sole trader usually operates on small scale only. So, he can not enjoy the benefits of large scale production or buying or selling. This may raise the cost of business operations.

### Check Your Progress A

- 1) Fill in the blanks.
- i) The liability of the sole trader is .....
  - ii) The whole profit of a sole trader organisation is pocketed by the .....
  - iii) Sole trade business organisation is suitable when the size of business is .....
  - iv) Number of owners in sole trader organisation is .....
  - v) In sole trader business, decision making is solely in the hands of .....
- 2) State whether the following statements are **True** or **False**.
- i) Sole proprietorship is most suitable for large scale business.
  - ii) In sole trader organisation, the proprietor is not distinct from the business concern.
  - iii) Capital raising capacity of a sole proprietorship is unlimited.
  - iv) In case of loss, the sole trader has to clear business obligations from his personal property.
  - v) A sole proprietorship is owned by many persons but is managed by only one person.

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## 5.3 PARTNERSHIP FORM OF ORGANISATION

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You have learnt that the sole trader organisations have limited financial resources, limited managerial ability and skills, and unlimited liability. In case of expansion more capital and more managerial skills are required. At the same time, the risk will also increase. A sole proprietor may not be able to fulfill all these requirements. A person who lacks managerial skills may be having capital. Another person who is a good manager may not be having sufficient capital. This calls for a situation where two or more persons come together, pool their capital and skills, and organise the business. This type of business organisation is called partnership organisation. It grew essentially because of the limitations and failure of the sole proprietorships.

As defined by J.L. Hanson, “a partnership is a form of business organisation in which two or more persons upto a maximum of twenty join together to undertake some form of business activity”. According to companies Act, 2013, the maximum persons have been increased to 50.

The Indian Partnership Act, 1932 defined partnership as “the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all”.

The Uniform Partnership Act of the USA defines a partnership “as an association of two or more persons to carry on as co-owners in a business for profit”.

Based on the above definitions, we can state that partnership is **an association of two or more persons who have joined together to share the profits of business carried on by all or any of them acting for all.**

The persons who own the partnership business are individually called ‘partners’ and collectively known as the ‘firm’ or ‘partnership firm’. On an agreed basis, partners contribute to capital and share the responsibility of running the business. However, in some cases one partner may provide the whole or major portion of the capital and others contribute technical and managerial skills with or without some capital. All such terms and conditions of partnership are usually mentioned in the partnership agreement.

### 5.3.1 Main Features

From the above discussion, we can list the main features of partnership form of organisation as follows :

- 1) **Plurality of persons;** To form a partnership firm, there should be at least two persons. The maximum limit has been 50 partners as per companies Act, 2013.
- 2) **Contractual relationship:** Partnership is created by an agreement between persons called ‘partners’. In other words, a person can become a partner only on the basis of a contract. This contract could be oral, written or implied.
- 3) **Profit sharing:** There must be an agreement among the partners to share the profits and losses of the business of the partnership firm. This is one of the basic elements of partnership. If two or more persons jointly own some property and share its income, it is not regarded as partnership.
- 4) **Existence of business:** The purpose of the agreement among the partners is to do some lawful business and share profits. If the purpose is something other than business, it should not be treated as partnership. For example, if the purpose is to carry some charitable work, it will not be treated as partnership.
- 5) **Principal-agent relationship:** The business of the firm may be carried on by all or one or more partners acting for all the partners. Every partner is entitled to take part in the operations of the firm. In dealing with other parties, each partner is entitled to represent the firm and other partners in respect of the business of the firm. All partners are bound by his acts done in the ordinary course of business and in firm’s name. In this sense, a partner is agent of the firm and the other partners.
- 6) **Unlimited liability:** In respect of business debts, each partner has unlimited liability. This means that if the assets of the firms are not sufficient to meet the obligations of the firm, the partners have to pay from their private assets.

The creditors can even realise the whole of their dues from one of the partners. Thus, all the partners are liable for all business debts and obligations.

- 7) **Good faith and honesty:** A partnership agreement rests on good faith among the partners. The partners must be honest to each other and trust each other. They must disclose every information about the business and present true accounts to one another.
- 8) **Restriction on transfer of share:** A partner cannot transfer his share to an outsider without the consent of all the other partners.

### 5.3.2 Classification of Partners

You have learnt that different partners play different roles in the operations of the firm. One partner may contribute more capital while another partner may spend more time in managing it. Depending on the role played, we can classify the partners into various categories. Look at Figure 5.2 for the classification of partners.

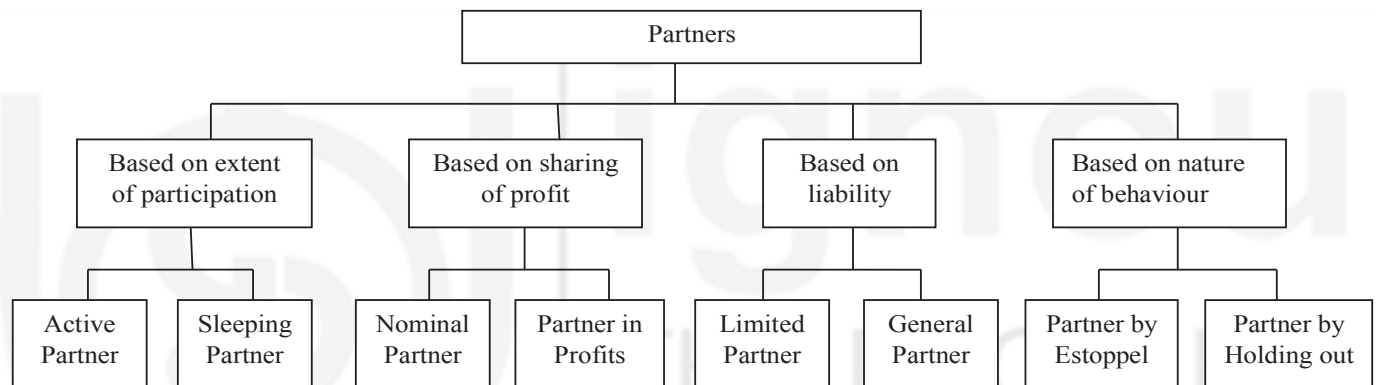


Fig. 5.2: Classification of Partners

**Based on the extent of participation** in the functioning of the business, we can classify partners into: (a) active partners, and (b) sleeping partners.

- a) **Active partner:** If a partner takes an active part in the management of the business, we call him as active partner. He is also known as a ‘working partner’.
- b) **Sleeping partner:** If the partner is not actively associated with the working of the partnership firm, we call him a sleeping partner. A sleeping business partner simply invests his capital. He does not participate in the functioning of the firm. Such a partner is also known as a ‘dormant partner’.

**Based on the sharing of profits,** partners may be classified into: (a) nominal partners, and (b) partner in profits.

- a) **Nominal partner:** A partner who just lends his name to the partnership is known as a nominal partner. He neither invests his capital nor participates in the day-to-day working and management of the firm. Such partners are not entitled to a share of profits, but they are liable to other parties for all the acts of the firm.

- b) **Partner in profits:** A partner who shares the profits of the business without being liable for losses is called a partner in profits. As a rule, he will not take any part in the management of the business. This is applicable to a minor who is admitted to the benefits of the firm.

**Based on the behaviour and conduct exhibited**, the partners may be divided into: (a) partner by estoppel, and (b) partner by holding out.

- a) **Partner by estoppel:** A person who behaves in the public in such a fashion as to give an impression that he is one of the partners in a partnership firm is called a partner by estoppel. Such partners are not entitled to profits but are fully liable as regards the firm's obligations.
- b) **Partners by holding out:** If a particular partner of a firm represents that another person is also a partner of the firm, and if such a person does not disclaim the partnership relationship even after coming to know about it, such person is called a 'partner by holding out'. Such partners are not entitled to profits but are liable as regards the obligations of the firm.

You should note the difference between these two types clearly. In the case of a partner by estoppel, the person's own behaviour and conduct have created a mistaken impression in the third parties mind that he is a partner of the firm. Whereas in the case of a partner by holding out, the other partners have represented the person as a partner, though he is not one, and he does not contradict it. You will learn more about such partners in a separate course.

**Based on liabilities** also, partners may be classified into two categories: (a) limited partners, and (b) general partners.

- a) **Limited partner:** The liability of such a partner is limited to the extent of the capital contributed by him. He is not entitled to take part in the management of the business, but he can advise the other general members. His acts do not bind the firm. He has right to inspect the books of the firm for his information. Such partners' are also called 'special partners'.
- b) **General partner:** He is also called 'unlimited partner'. His liability is unlimited and he is entitled to participate in the management of the business. Every partner who is not a limited partner is treated as a general partner.

### 5.3.3 Partnership Deed

You know that a partnership is formed by an agreement. Such agreement may be either written or oral. To avoid misunderstanding and unnecessary litigations, it is always desirable to have a written agreement. When the written agreement is duly stamped and registered, it is known as 'Partnership Deed'. After registration, each partner is given a copy of the partnership deed. A partnership deed, generally contains the following particulars.

- 1) Name of the firm.
- 2) Nature of the business to be carried out.
- 3) Names of the partners.
- 4) The town and the place where business will be carried on.



- 5) The amount of capital to be contributed by each partner.
- 6) The profit and loss sharing ratio of each partner.
- 7) Loans and advances by partners and the interest payable on them.
- 8) The amount of drawings by each partner and the rate of interest allowed thereon.
- 9) The rate of interest on capital.
- 10) Duties, powers, and obligations of partners.
- 11) Remuneration, if any, payable to the active partner.
- 12) Maintenance of accounts and arrangements for audit.
- 13) Settlement in the case of dissolution of partnership.
- 14) The methods of evaluation of goodwill on admission or death or retirement of a partner.
- 15) The method of revaluation of assets and liabilities on admission or death or retirement of a partner.
- 16) The method of retirement of a partner and the arrangement for the payment of the dues of a retired or deceased partner.
- 17) Arbitration in case of disputes among partners.
- 18) Arrangements in case of partner becomes insolvent.

This is not an exhaustive list. Any other clauses, as desired by the partners, could be included in the partnership deed. In fact, the Partnership Act defines certain rights and duties of a partner. But the provisions of the Act come into operation only when there is no agreement amongst the partners.

**Registration of the firm:** Under the Indian Partnership Act, it is not compulsory to register the firm. But there are certain limitations for an unregistered firm. So it is better to register it. Registration can be done at any time. To register the firm, an application with all particulars about the firm and registration fee has to be sent to the Registrar of Firms.

### 5.3.4 Merits and Limitations

You have learnt about the main features of partnership. This would help you to identify the merits and limitations of this form of organisation which are as follows:

#### Merits

- 1) **Easy formation:** Although the formation of a partnership firm is not as easy as the sole proprietorship, but it is much less difficult as compared to a company. The partners agree to do business together and draw up and sign the partnership agreement. After that there are no complex government laws regulating the establishment of the partnership.
- 2) **More capital available:** Unlike sole proprietorship, there are two or more partners in partnership firms. So a partnership firm does not have to rely on a single individual as the source of its funds. The added financial strength of the partners increases the borrowing capacity of the firm.

- 3) **More diverse skills and expertise:** The partnership involves more people in decision making because there are more owners. An ideal partnership brings together partners who complement each other, not partners who have the same background and experience. One partner might be a specialist in manufacturing, another in marketing, and the third partner might be an accountant. Combined judgement of all these partners often leads to better decisions than otherwise.
- 4) **Flexibility:** Like sole proprietorship, the partnership business is also owned and run by the partners themselves. They can easily appreciate and quickly respond to the changing conditions.
- 5) **Secrecy:** In partnership firms, some secrecy can be maintained because there is no obligation to publish accounts of the firm.
- 6) **Keen interest:** Since partners are liable to losses and risks of a business they take keen interest in the affairs of the business.
- 7) **Protection:** Due to the rule of unanimity in fundamental matters, the rights of all partners are fully protected. If a partner is dissatisfied with the working of firm, he can ask for dissolution of the firm and withdraw from the business.
- 8) **Checks and controls over careless decisions:** Since the partnership is run on collective basis and all partners participate in major decisions, there is lesser scope for reckless and hasty decisions.
- 9) **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.

### Limitations

- 1) **Limited capital:** Since there is a limit of maximum partners (50), the capital raising capacity of the partnership firms is limited as compared to a joint stock company.
- 2) **Unlimited liability:** The most important drawback of a partnership firm is that the liability of the partners is unlimited.
- 3) **No public confidence:** Since the accounts are not published and publicised, the firm may not be able to command confidence of the public.
- 4) **Non-transferability of interest:** No partner can transfer his interest in a firm without the consent of other partners.
- 5) **Uncertainty:** The sudden death, lunacy or insolvency of a partner leads to the dissolution of partnership. This breeds uncertainty in the continuity of a partnership firm. However, this could be partly avoided if such matters are specified in the partnership agreement.
- 6) **Conflicts among partners:** There is scope for misunderstanding and conflicts among the partners. This may cause delays in decision making and may lead even to dissolution of the firm. To some extent, this problem could be avoided if the partnership agreement is clear and detailed.



- 7) **Risk of implied authority:** Since each partner acts as an agent of the firm, acts of one partner would bind the firm and all the remaining partners. A dishonest or incompetent partner may lend the firm into difficulties and the other partners may have to pay for it.

### 5.3.5 Joint Hindu Family Firm

Joint Hindu Family firm is a unique form of business organisation prevailing only in India. This is the firm belonging to joint Hindu family and governed by the provisions of the Hindu Law.

In Hindu Law there are two schools:

- a) **Mitakshara:** It is applicable to the whole of India except Bengal and Assam. According to this school, a Hindu inherits property from his father, grand father, and great grand father. Thus, three successive generations in the male line (son, grandson, and great grandson) inherit the ancestral property. They are called coparceners and the senior most member of the family is called 'Karta'. The Hindu Succession Act, 1956 has extended the line of coparcenary interest to female relatives of the deceased coparcener or male relatives claiming through such female relatives.
- b) **Dayabhaga:** It is applicable in Bengal and Assam. According to this, the male heirs become members only on the death of the father.

According to Hindu Law, a business is an inheritable asset. After the death of Hindu, the business will be jointly owned by all the coparceners. The elder person among the coparceners becomes the new Karta and manages the business. If any property is inherited from any other relative, or acquired from personal resources, such property is regarded as personal property and treated as distinct from ancestral property.

Important features of the Joint Hindu Family Firm are:

- 1) Business is managed by the senior member of the family called Karta. Other members do not have the right to participate in the management of the firm.
- 2) Other members cannot question the authority of the Karta. Their only remedy is to get the family dissolved by mutual agreement.
- 3) Karta has the power to borrow funds for the business. The liability of the Karta is unlimited whereas the other coparceners are liable only to the extent of their share in the business.
- 4) If the Karta has misappropriated the funds of the business, he has to compensate the other coparceners to the extent of their shares in the joint property.
- 5) The death of any member of the family does not dissolve the business or the family.
- 6) Through mutual agreement the joint Hindu family firm can be dissolved.

You should note the difference between the joint Hindu family firm and the partnership firm. A joint Hindu family firm is the result of the operation of the Hindu Law. No formal agreement is required to convert a business into a joint Hindu family business. The members of the family automatically become

coparceners. Only the Karta can participate in the management. The liability of the Karta is unlimited but the liability of the other coparceners is limited to their shares in the business. The rights, duties and liabilities of coparceners are governed by the provisions of the Hindu Law. Partnership is the result of an agreement between the persons who need not be blood relatives. Each partner has the right to participate in the management of the business. The liability of each partner is unlimited. The duties, rights and liabilities of the partners are governed by the Indian Partnership Act, 1932.

### 5.3.6 Limited Liability Partnership

Limited Liability Partnership (LLP) Act, 2008, is a new piece of legislation. This Act enables formation of partnerships with liability of partners being kept limited like that of share holders as in case of companies. Thus, the public has been given a choice to form a partnership either under the partnership law, i.e., Partnership Act, 1932 or under LLP Act, 2008. The features of this limited liability partnership are as follows:

- 1) **Regulating Act:** A LLP is regulated by the Limited Liability Partnership Act, 2008.
- 2) **Minimum and Maximum Number of Members:** In case of LLP, minimum numbers of partners required are 2. There is no limit to maximum number of partners.
- 3) **Governance Structure:** The governance structure would be by contractual agreement between partners.
- 4) **Management:** The management rests with those partners (including designated partners) who are authorised by LLP agreement.
- 5) **Transfer of Interest:** In the case of a limited liability partnership, a partner's economic rights (i.e. right to a share of the profits and losses and to receive contribution at the time of winding up) shall be transferable (Section 42). However, such transfer shall not by itself cause the disassociation of the partner and a dissolution and winding-up of the LLP. Further, such transfer would not make the transferee a 'partner' of the LLP entitled to participate in its management (Section 42). For becoming a partner of LLP, unless otherwise provided in the LLP agreement, consent of all the existing partners is required (Schedule I appended to LLP Act).
- 6) **Audit:** If the capital contribution does not exceed Rs. 25 lakhs or if the annual turnover does not exceed Rs. 40 lakhs [Rule 24(8) of the LLP Rules, 2009] audit is not compulsory.
- 7) **Meeting:** In LLP, the annual meeting of partners is not mandatory.

#### Check Your Progress B

- 1) Fill in the blanks.
  - i) The maximum number of partners in a partnership firm is .....
  - ii) Liability of partners in a partnership firm is .....
  - iii) A partner who is not participating in the management of the firm is called ..... partner.

- iv) The minimum number of members in a partnership firm is.....
  - v) A registered partnership agreement is called .....
  - vi) A person's own behaviour has created the impression that he is one of the partners of a partnership firm. Such partner is called .....
  - vii) If the liability of the partner is limited to the capital contributed by him, such a partner is called .....
- 2) State whether the following statements are **True** or **False**.
- i) Partnership agreement must be in writing.
  - ii) There is no maximum limit for membership in a partnership organisation.
  - iii) Members of a partnership firm are called partners.
  - iv) A partner can transfer his share to some other person without the consent of the other partners.
  - v) Every partner is a proprietor of the firm and also an agent of the firm.
  - vi) A sleeping partner actively participates in the working of the firm.
  - vii) A person who is a partner by holding out is entitled to share the profits.
  - viii) The acts of one partner would bind the firm and the remaining partners.

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## **5.4 COMPANY FORM OF ORGANISATION**

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You have learnt that sole proprietorships and partnerships have the disadvantages of limited resources, unlimited liability, limited managerial skills, etc. The life and stability of these organisations also depend on the life and stability of the proprietors/partners. Hence, they are not considered suitable for large scale business.

For large scale business, you require large investment and specialised managerial skills. The element of risk is also very high. This situation led to the emergence of company form of business organisation. In case of joint stock company, capital is contributed by not one or two persons but by a number of persons called shareholders. Thus, it is possible to raise large amount of capital. A joint stock company is an association of persons registered under Companies Act for carrying on some business. It is called an artificial person as it is created by law, with a distinctive name, a common seal and perpetual succession of members. It can sue and be sued in its own name. The most widely quoted definition of a company (called Corporation in USA) is the one given by Chief Justice Marshal. According to him "a corporation is an artificial being, invisible, intangible and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or an incidental to its very existence". Lord Justice Lindley has defined it 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 it or to whom it belongs are members. The proportion of capital to which each member is entitled is his share”.

The Indian Companies Act (1956) 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”.

### 5.4.1 Main Features

Based on the above definitions, we can list out the features of the company form of organisation as follows:

- 1) **Incorporation:** A company is an incorporated association. It comes into existence only after registration under the Companies Act.
- 2) **Artificial Person:** A company is regarded as an artificial person as it is created by law and can be effaced only by law. It has no body, no soul, no conscience, still it is in a position to exist. Like any other person it can own property, conduct a lawful business, enter into contracts with others, buy, sell and hold property, all under its own name and its own seal.
- 3) **Separate legal entity:** A company has a distinct entity separate from its members. A shareholder of a company can enter into contract with the company and can sue the company and be sued by it. You know that in the case of partnership, every partner is an agent of the firm and also that of the other partners. But the shareholder is not the agent of the company or its shareholders. He can not bind them with his acts.
- 4) **Common seal:** As the company is not a natural person, it can not sign the documents. It has a device in the form of common seal on which its name is engraved. This common seal is a substitute of its signatures. It is affixed on all important legal documents and contracts. It is used at the direction of the board of directors and two directors have to sign as witnesses wherever it is affixed on any document.
- 5) **Perpetual succession:** A joint stock company has a continuous existence. Its life is not affected by the death, lunacy, insolvency or retirement of its shareholders or directors. Members may come and go, but the company continues its operations until it is legally dissolved. Thus, a company has perpetual succession irrespective of its membership. This feature provides stability to this form of organisation.
- 6) **Separation of ownership and management:** The shareholders of a company are widely scattered throughout the country. For the conduct of the business and its management, shareholders elect another set of persons known as directors. The right to manage the company affairs is vested in the directors who are elected representatives of the shareholders. Thus, ownership is separated from management.

- 7) **Number of members:** In the case of a public limited company, the minimum number is seven and there is no maximum limit. In the case of a private limited company, minimum number is two and the maximum is two hundred.
- 8) **Limited liability:** The liability of the members of a company is normally limited by guarantee or by the shares. Members liability is limited to the amount of shares held. Members are not personally liable for the debts of the company. So personal properties of the members are not liable to be attached for the payment of the company's debts.

For example, the face value of the share of a company is Rs. 10 which the member has already paid. At the time of winding up of the company, the member cannot be asked to pay any money. But if the member had paid only Rs. 7, he can at the most be asked to pay the balance of Rs. 3 (face value Rs.10 minus money paid Rs. 7), and no more.

- 9) **Transferability of shares:** The member of a public limited company enjoys a statutory right to sell his shares to others without the consent of other shareholders. But for transferring the shares he has to follow the procedure laid down in the Companies Act. However, there are restrictions for transferring shares in case of a private limited company.
- 10) **Rigidity of objects:** The scope of the business of a company is limited. The type of business in which the company would participate is mentioned in the 'object clause' of its Memorandum of Association. The company cannot take up any new business without changing the object clause. To change the object clause, the company has to comply with the provisions of the Companies Act.
- 11) **Statutory regulations:** A company is governed by the Companies Act and it has to follow various provisions of the Act. It has to submit a number of returns to the Government. Accounts of a company must be audited by a Chartered Accountant. Thus, the company form of organisation has to comply with numerous and varied statutory requirements.

Having studied the features of a joint stock company, you can easily make out that the shareholders are the real owners of the company. Their liability is limited. They can also transfer their shares to others. Since the shareholders are very large in number, the company cannot be managed by all. They elect a board of directors to manage the company. The destiny of the company is guided and directed by the directors. These directors employ some people to carry on the day-to-day business of the company. The company can raise additional funds by issuing debentures (also called bonds).

## 5.4.2 Classification of Companies

We can classify companies on the basis of 1) Mode of incorporation, 2) Extent of liability, 3) Category of shareholders, and 4) Jurisdiction of functioning. Look at Figure 5.3 for the classification of companies.

- 1) On the basis of the mode of incorporation, we can classify companies into three categories:
  - a) **Statutory Company:** A company established by a special Act of the Parliament or State Legislature is called 'Statutory Company'. Such



companies are established in special cases when it is necessary to regulate the working of the company for some specific purposes. Examples of such corporations are Reserve bank of India, Life Insurance Corporation of India, Air India Corporation, Food Corporation of India, etc. These are mostly public sector enterprises.

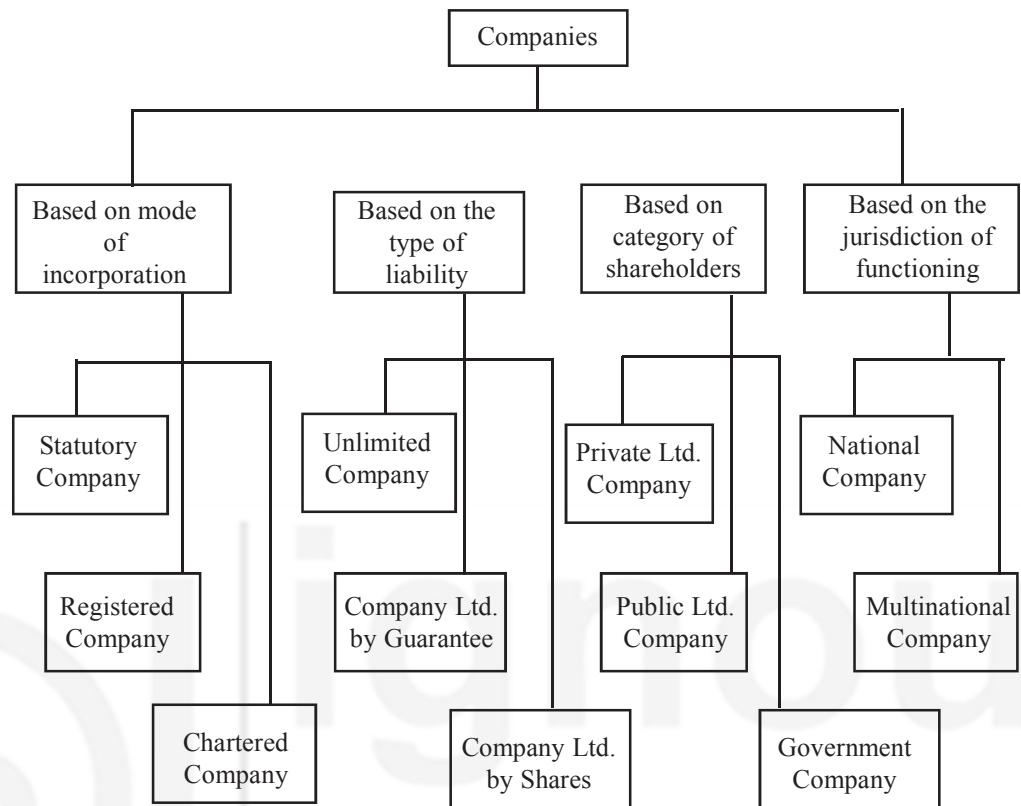


Fig. 5.3: Classification of Companies

- b) **Registered Company:** A company which is incorporated through registration with the Registrar of Companies under the Companies Act, 1956, is called a ‘Registered Company’. This is also called ‘Incorporated Company’. All companies established under the private sector belong to this category.
- c) **Chartered Company:** A company which is incorporated under a special Royal Charter granted by the Monarch is called a ‘Chartered Company’. It is regulated by the provisions of that charter. Examples are: British East India Company, Bank of England, Hudson’s Bay Company, etc. In India this type of companies does not exist now because there is no monarchy.
- 2) Based on the type of liability, companies may be classified into three categories:
- a) **Unlimited Companies:** A company in which the liability of the members is unlimited, is called ‘Unlimited Company’. At the time of winding up of the company shareholders have to pay, if necessary, from their personal assets to clear the company’s debts. From this point of view, it is very much like sole proprietorship and partnership. However, such companies are very rare.
- b) **Companies Limited by Guarantee:** In the case of some companies, members give guarantee for the debts of the company up to a certain

limit in addition to the amount of shares held by them. The additional amount guaranteed by the members is generally, laid down in the Memorandum of Association. Such companies are not formed for the purpose of profit. They are formed to promote art, culture, religion, trade, sports, etc. Clubs, Charitable organisations, trade association, etc.

c) **Companies Limited by Shares:** In this case, the liability of the members is limited to the amount of the shares held by them. A shareholder can be called upon to pay only the unpaid amount of shares held by him and nothing more. Most of the companies come under this category.

3) On the basis of the ownership, companies may be classified into three categories:

a) **Private Limited Company:** A private limited company means a company which by its article.

- i) Restricts the right to transfer its shares;
- ii) Limits the number of its members to minimum 2 and maximum 200; and
- iii) Prohibits any invitation to the public to subscribe for any shares or debentures of the company.

b) **Public Limited Company:** A public limited company is one which is not a private limited company. A company having the following characteristics should be called a public limited company.

- i) The right of the shareholder to transfer his shares is not restricted.
- ii) The minimum number of shareholders is 7 but there is not limit to the maximum number of members.
- iii) It can invite public to subscribe for its shares and debentures.

The minimum number of members in the case of a private limited company is two and can be formed more easily as compared to a public company. It is exempted from various regulations of the Companies Act and thus combines the advantages of limited liability and the facilities of a partnership organisation. It is considered suitable for a medium sized business.

d) **Government Company:** A company in which not less than 51 per cent of the paid up share capital is held by the Central Government, or by any State Government or jointly by Central and/or State Governments.

4) On the basis of the jurisdiction of the functioning, we can classify companies into two categories.

a) **National Company:** When the operations of a company are confined within the boundaries of the country in which it is registered, such a company is called a national company.

b) **Multinational Company:** When the operations of a company are extended beyond the boundaries of the country in which it is registered, such a company is called a multinational company. It is also called 'transnational company'.



### 5.4.3 Merits and Limitations

The company form of organisation has been popular and successful in almost all the countries. This form is suitable where large resources are required and the production has to be carried out on a large scale. The number of joint stock companies has shown a phenomenal increase in the twentieth century. Let us now discuss the merits and limitations of the company form of organisation.

#### Merits

- 1) **Large capital:** Since company forms of organisation are allowed to have a large number of shareholders, it is possible to raise capital in large amounts. Whenever new capital is required, it can issue shares and debentures. For this reason, only the company form of organisation is best suited.
- 2) **Limited liability:** The liability of shareholders, unless and otherwise stated, is limited to the face value of the shares held by them or guarantee given by them. Their private property is not attachable to recover the dues of the company. Thus, this form of organisation is a great attraction to persons who are not willing to take risk as is inherent in sole proprietorship and partnership.
- 3) **Stability of existence:** A company has a separate legal entity with perpetual succession. The Corporation is not affected by lunacy or insolvency of a shareholder, director or officer. The continuity of the company is desirable in the interest of not only its members but also the society.
- 4) **Economies of scale:** As companies operate on a large scale, they can take advantage of large scale buying, selling, production, etc. As a result of these economies of large scale operations, companies can provide goods to consumers at a cheaper price.
- 5) **Scope for expansion:** As there is no limit to the maximum number of shareholders in a public limited company, expansion of business is easy by issuing new shares and debentures. Companies normally keep part of their profits as reserve and use them for expansion.
- 6) **Public confidence:** Companies are subject to Government controls and regulations. Their accounts are audited by a chartered accountant and are to be published. This creates confidence in the public about the functioning of the company.
- 7) **Transferability of shares:** The shares of the public limited company can be sold at any time in the stock exchange. Shareholders can sell their shares whenever they want. There is no need to take the consent of other shareholders. Thus, shareholders can convert their shares into cash at any time without much difficulty.
- 8) **Professional management:** You know that the management of a company is in the hands of the directors who are elected by shareholders. Normally, experienced persons are elected as directors. You also know that day-to-day activities are managed by salaried managers. These managers are the experts in their respective fields. As companies have large scale operations and profits, attracting good professional managers are easy by paying

attractive salaries. Thus, company form of organisation gets the services of professionals on the Board of Directors and in various management positions.

- 9) **Tax benefits:** Companies pay income tax at flat rates. There is no provision for slab system in the taxation of companies. As a result, companies pay lower taxes on higher incomes compared to other forms of organisations. Companies also get some tax concessions if they are established in backward areas.
- 10) **Risk diffused:** As the membership is very large, the business risk is divided among the several members of the company. This is an advantage for small investors.

### Limitations

- 1) **Difficulty in formation:** Promotion of a company is not as simple as proprietorships and partnerships. A number of persons known as promoters should be ready to associate themselves with it for getting a company incorporated. A lot of legal formalities are to be performed at the time of registration. Promotion of a company is expensive as well as complicated.
- 2) **Lack of secrecy:** The management of companies is usually in the hands of many persons. Everything is discussed in the meetings of Board of Directors. Therefore, compared to sole trader and partnership concerns, maintaining business secrets is relatively difficult in a company form of organisation.
- 3) **Delay in decision making:** In company form of organisation all important decisions are taken by either the Board of Directors or shareholders in their meetings. Hence, decision making process is time consuming. If a quick decision is needed it will be difficult to arrange meetings all of a sudden. So, some business opportunities may be lost because of delay in decision making.
- 4) **Neglect of minority interest:** The representatives of the majority group of shareholders become the members in the Board of Directors. The shareholders who are in minority never get representation on the Board of Directors. As a consequence, the interests of the minority members may be neglected and oppressed at the hands of the majority group.
- 5) **Concentration of economic power:** The company form of organisation gives scope for concentration of economic power in a few hands. Some persons become directors in a number of companies and formulate policies to promote their personal interests. The shares of a number of other companies are purchased to create subsidiary companies. Establishment of subsidiary companies and interlocking of directorships have facilitated concentration of economic power in the hands of a few business houses.
- 6) **Lack of personal interest:** In sole proprietorship and partnership firms business is managed by owners themselves. In company form of organisation, day-to day management is vested with the salaried executives who do not have any personal interest in the company. This may lead to reduced employee motivation and result in inefficiency.

- 7) **More government restrictions:** A company is subject to many restrictions from which the proprietorships and partnerships are exempted. So, it has to spend considerable time and effort in complying with the various legal requirements.
- 8) **Fraudulent management:** There is a possibility that some unscrupulous promoters may float a bogus company, issue shares and collect money. Later on, they can get away with the money by putting the company in liquidation. It is also possible that the directors and professional managers may misuse the company resources for their personal benefit and bring losses to the company.

#### 5.4.4 One Person Company (OPC)

Section 2(62) of the Companies Act, 2013 defines 'One Person Company' to mean a company with only one person as its member. Section 3(1) (c) provides that a company may be formed for any lawful purpose by one person, where the company to be formed is to be One Person Company, that is to say, a private company by subscribing his name to a memorandum and complying with the requirements of the Act in respect of registration.

##### **An OPC may be registered as 'limited by shares' or 'limited by guarantee'**

However, the memorandum of One person Company shall indicate the name of the other person, with his prior written consent in the prescribed form (Form No. INC.3), who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.

Such other person may withdraw his consent in such manner as may be prescribed.

On the death of the promoter member of an OPC, the person nominated by such promoter member shall be the person recognised by the company as having title to all the shares of the member and shall be entitled to the same dividends and other rights and liabilities to which such sole promoter member of the company was entitled or liable.

The member of One Person Company may at any time change the name of such other person by giving notice and shall intimate the Registrar any such change within such time and in such manner as may be prescribed.

The words "One Person Company" shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.

##### **Relaxations available to OPCs**

Relaxations given to an OPC include:

- 1) There is no need to prepare a cash-flow statement [Section 2(40)].
- 2) The annual return can be signed by the Director and not necessarily a Company Secretary (Section 92).
- 3) There is no necessity for an Annual General Meeting (AGM) to be held (Section 96).

- 4) Specific provisions related to general meetings and extraordinary general meetings would not apply (Sections 100 to 111).
- 5) Compliance can be said to have been done if the resolutions are entered in the minutes' book of the company (Section 122).
- 6) It would suffice if one director signs the audited financial statements (Section 134).
- 7) Financial statements can be filed within six months from the close of the financial year as against 30 days (Section 137).
- 8) An OPC needs to hold only one meeting of the Board of Directors in each half of a calendar year and the gap between the two meetings should not be less than ninety days (Section 173).

### Special Provisions Applicable to OPCs

Where the OPC limited by shares or by guarantee enters into a contract with the sole member of the company who is also the director of the company, the company shall, unless the contract is in writing, ensure that the terms of the contract or offer are contained in a memorandum or are recorded in the minutes of the first meeting of the Board of Directors of the company held next after entering into contract (Section 193). This will not apply to contracts entered into by Company in the ordinary course of its business.

### As per the Rules Framed by the Central Government:

- 1) Only a natural person who is an Indian citizen and resident in India shall be eligible to incorporate a One Person Company or be appointed as a nominee for the sole member of a One person Company. The term "resident in India" means a person who has stayed in India for a period of not less than 182 days during the immediately preceding 1 financial year (Rule No. 3.1).
- 2) No person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company (*Rule No. 3.2.*).
- 3) No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest (*Rule no. 3.4.*).
- 4) Such Company cannot be incorporated or converted into a company under section 8 of the Act (*Rule No 3.5*) or carry out Non-Banking Financial Investment activities including investment in securities of any body corporate (*Rule No. 3.6*).
- 5) Where the paid up share capital of a One Person Company exceeds 50 lakh rupees and its average annual turnover during the relevant period exceeds 2 crore rupees, it shall cease to be entitled to continue as a One Person Company. (***Rule No. 3.7. It may convert itself into a private or public company within a period of 6 months from the date its paid up capital exceeds Rs. 50 lakh and turnover exceeds Rs. 2 crore (Rule No. 6).***)
- 6) **Conversion of One Person Company into a private company or a public company:** One Person company can get itself converted into a Private or Public company after increasing the minimum number of members and directors to 2 or minimum of 7 members and 3 directors as the case may be, and by maintaining the minimum paid-up capital as per requirements of the

Act for such class of company and by making due compliance of section 18 of the Act for conversion i.e. Conversion of companies already registered **(Rule No. 6). However, such a company cannot convert voluntarily into any kind of company unless two years is expired from the date of its incorporation (Rule No. 3, 7).**

### 5.4.5 Small Company

The concept of Small Company has also been introduced for the first time in the Companies Act, 2013. According to Section 2(85) of the Companies Act, 2013, “small company” means a company, other than a public company.

- i) Paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; and
- ii) Turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees;

However, the expression ‘small company’ shall not include:

- a) a holding company or a subsidiary company;
- b) non-profit association (i.e, companies registered under Section 8 of the Companies Act, 2013);
- c) a company or body corporate governed by any special Act.

In such company there is no need to prepare cash flow statement, annual return can be signed by the Director or Secretary and to hold only one meeting in one half of calendar year and gap between two meeting should not be more than 90 days.

### Check Your Progress C

- 1) State whether the following statements are **True** or **False**
  - i) In the case of companies, shareholders cannot transfer their shares to others.
  - ii) A company is a legal person created by law.
  - iii) A company form of organisation is not suitable for large scale business.
  - iv) Compared to sole proprietorship and partnership, companies can avail the benefits of economies of large scale.
  - v) Company can not buy property on its own name.
  - vi) There are less legal formalities to start a company.
  - vii) Company is separate from its owners and it has an entity of its own.
  - viii) A company has to be closed if the majority of the shareholders are dead.

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## 5.5 COOPERATIVE FORM OF ORGANISATION

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Cooperative organisations are generally started by the poor and the economically weak sections to promote their common economic interests through business propositions. The basic philosophy of cooperative organisation is self-help and



mutual help. The primary objective of any cooperative organisation is to render service to its members. In this respect, it is different from the other three forms of organisations which are primarily meant for making profits. The important features of the cooperative organisation are service in place of profit, mutual help in place of competition, self-help in place of dependence, and moral solidarity in place of unethical business practices.

As defined by International Labour Office “Cooperative organisation is an association of persons, usually of limited means, who have voluntarily joined together to achieve a common economic end through the formation of a democratically controlled business organisation, making equitable contributions to capital required and accepting a fair share of risks and benefits of the undertaking.”

Calvert has defined cooperation as “a form of organisation wherein persons voluntarily associate together as human beings on the basis of equality for the promotion of the economic interests of themselves.”

The Indian Cooperation Societies Act, 1912, Section 4, defined it as “a society which has as its objectives the promotion of economic interests of its members in accordance with cooperative principles.”

Based on these definitions, we can state that the cooperative organisation is a ‘voluntary’ association of persons who are not financially strong and cannot stand on their own legs. They come together not with a view to get profits but to overcome destability arising out of the want of adequate financial resources. The basic objective of such an organisation is self-help and mutual help.

Cooperative organisations are to be registered with the Registrar of Cooperative Societies of the concerned state in which the society’s registered office is situated. There should be minimum of 10 members to form a cooperative. But there is no maximum limit for membership.

Like the company form of organisation, the members of the society are the owners. They contribute the required capital and get a share in the profit, which is known as dividend. The liability of the members is limited.

Management is vested in the hands of the managing committee which is elected by the members in the annual general meeting.

### 5.5.1 Main Features

Based on the above discussion, we can identify the following distinctive features of cooperative organisations.

- 1) **Voluntary association:** As stated above, persons desirous of pursuing a common objective can form themselves into an association and leave the same as and when one likes. This has two important connotations:
  - a) Any person can become a member irrespective of his caste, creed, religion, colour, sex, etc.
  - b) The members come together to form themselves into an association without any coercion or intimidation.
- 2) **Autonomy and stability:** Within the limits set by the constitution, the general law and its charter, a cooperative society is a self governing

organisation. It is self-sufficient, self-renewing, and self-controlling within its jurisdiction. Like a company, a cooperative organisation also enjoys a separate and independent entity distinct from that of its members. As such, it has a perpetual life and is not affected by the entry and exit of members.

- 3) **Democratic management:** The management of cooperative organisation vests in a managing committee elected by members on the basis of 'one member-one vote' irrespective of the number of shares held by any member. It is the general body of the members which lays down the broad framework of policy within which the managing committee has to function. Democracy is, thus, the keynote of the management of a cooperative society.
- 4) **Capital:** The capital is procured from its members in the form of share capital. However, the share capital constitutes only a limited source of business finance. The major part is raised either by way of loan from the government and the apex cooperative institutions, or by way of grants and assistance from the central or state governments.
- 5) **Government control:** In India, all cooperative societies are registered under Cooperative Societies Act, 1919 or other State Cooperative Societies Act. Cooperative societies are subjected to detailed regulation under these Acts.
- 6) **Service motive:** The primary objective of any cooperative society is to provide service to its members. As you know, in the case of the other three forms of organisations the primary objective is to earn profits.
- 7) **Limited return on capital:** In cooperative system, profits are distributed among the shareholders for the capital they have contributed. But the rate of dividend paid to the shareholders is limited to 9% as per the Cooperative Societies Act.
- 8) **Distribution of surplus:** In case of a partnership firm and a company, profits are distributed among the members in the ratio of the capital contributed by each of them. In case of cooperative societies, after giving a limited dividend to shareholders, the surplus profits are distributed in the form of bonus. This bonus is not in the proportion of the share capital, but in the proportion of the business they have done with the society. For example, in case of a consumer cooperative society, bonus is paid in the proportion of the purchases made by the members from the society. Similarly, in case of a producer' society, bonus is paid in the proportion of the goods delivered for sale to the society.

### 5.5.2 Classification of Cooperatives

Cooperatives were started in different fields to promote the well being of different section of the society. Therefore, there are different types of cooperative societies. The important types are given below.

- 1) **Consumer Cooperatives:** People who want to obtain their day-to-day household good at reasonable prices form consumer cooperative societies. The main objective of these societies is to protect the members from the evils of unfair trade and the steep rise in prices. These societies purchase goods in bulk from wholesalers or producers and sell them to its members, sometimes also to non-members.



- 2) **Producer's Cooperatives:** These are the societies formed by the small industrial producers and artisans. They are also called industrial cooperatives. The main objective is to protect the small producers and workers from exploitation. They provide credit facility, supply raw-materials, market the products produced by members, and help the members to buy machinery on hire purchase.
- 3) **Marketing Cooperatives:** When the producers form into a cooperative society for the purpose of arranging the sale of their output, it is called marketing cooperative. These societies are started in order to protect producers from exploitation by the middlemen when they market their products.
- 4) **Housing Cooperatives:** These societies mainly operate in urban areas. They are mainly formed to provide housing facility to its members. The housing societies acquire land, plan the lay out and construct houses, and later allot them to the members. Some of them simply develop the land and allot plots to its members who then construct houses on their own. The society helps in arranging loans for them.
- 5) **Credit Cooperatives:** Credit societies are started by persons who are in need of credit. Such societies provide credit to their members at a reasonable rate of interest. These credit societies may be classified into agricultural credit societies and non-agricultural credit societies. Agricultural credit societies are started to provide loans to farmers to meet the expenses in cultivation. These societies may be further classified into two groups: i) societies which provide short term and medium term credit, and ii) societies which are concerned with long term credit.

Non-agricultural credit societies are formed by the employees of industrial units and various institutions. They can also be organised by small traders, artisans and people of low income groups in towns and cities to meet their credit requirements. Under this category, there are cooperative urban banks, thrift societies, employees credit society, industrial cooperative banks, house mortgage banks, etc.

- 6) **Farming Cooperatives:** Economies of large scale operations cannot be derived by small farmers. Therefore, small farmers form into a cooperative society, carry on the work jointly and share the returns. These societies are most helpful to small and marginal farmers and enable them to get the advantages of large scale operations. They may form a cooperative better farming society, a cooperative tenant farming society, a cooperative joint farming society, a cooperative collective farming society, etc.

In addition to the cooperatives described above, there are many other types of cooperative because the principle of cooperation is extended to a large number of activities and operations. There are cooperatives such as processing cooperatives, construction cooperatives, transport cooperatives, auto rickshaw cooperatives, washer men cooperatives, fishery cooperatives, dairy cooperatives, sugarcane growers cooperatives, oilseeds growers cooperatives, etc. The aim of all these societies is to promote the welfare of their members.

### 5.5.3 Merits and Limitations

Different types of cooperatives have distinct merits and limitations. But there are some common merits and limitations which can be traced to all types of cooperative societies.

#### Merits

- 1) **Easy formation:** Formation of a cooperative society is easy as compared to the formation of a company. Cooperative society is a voluntary association and so it does not require long and complicated legal formalities at the time of formation. Any 10 adult persons can voluntarily form themselves into an association and get it registered with the Registrar of Cooperatives.
- 2) **Limited liability:** Like company form of organisation, liability of members is limited in cooperative societies also.
- 3) **Social services:** Cooperatives foster fellow feeling among members and impart moral and educative values in their everyday life which are essential for better living.
- 4) **State assistance:** Cooperatives have been adopted by the government as an instrument of economic policy. So, a number of grants, loans and financial assistance are offered by the government to these societies to make them function effectively.
- 5) **Open membership:** The membership of cooperative societies is open to everybody. Nobody is debarred from joining on the basis of economic position, caste, colour or creed. There is no limit on the maximum number.
- 6) **Supply of goods at cheaper rates:** The societies purchase goods directly from producers and sell them to the members at cheap rates. The middlemen are eliminated from the channel of distribution. The consumer cooperatives supply essential goods to the members at a time when there is scarcity of goods in the market. Even capital goods (like machinery, etc.) are procured directly from producers and are supplied to the members. So cooperative societies ensure regular supply of goods at cheaper rates.

#### Limitations

- 1) **Lack of business acumen:** Members normally do not have business experience. As a consequence, when they become the members of the Board of Directors, the society is not conducted efficiently. Unlike companies, cooperatives cannot employ outside talents and trained personnel for improving the management competency. This is because such steps are incompatible with their avowed ends and limited means.
- 2) **Absence of mutual interest:** A cooperative can only succeed when the members are imbued with a spirit of cooperation. Unfortunately, some influential members use the cooperative society as a source of their personal gains.
- 3) **Lack of interest:** Sustained efforts over a period are the prerequisites for success in any business. But such a state of affairs does not exist in many cooperatives. Within a short period of its dramatic start, the cooperative becomes lifeless and inactive in its operation.

- 4) **Lack of coordination:** It cannot be denied that internal dissensions and rivalries among the members sap much of its strength and vigour. The absence of coordinated and joint action is responsible for the collapse of many cooperative associations.
- 5) **Corruption:** One of the most important drawbacks of a cooperative form of organisation is the prevalence of corrupt practices in the management and functioning of the cooperative societies.
- 6) **Lack of secrecy:** The affairs of cooperatives are generally exposed to the members and it becomes quite difficult for them to maintain secrecy in business affairs.
- 7) **Insufficient motivation:** Since the rate of return on capital is low, the members do not feel involved in the affairs of the society.

### Check Your Progress D

- 1) State whether the following statements are **True** or **False**.
  - i) Earning profit is the primary objective of cooperative organisation.
  - ii) Management of cooperatives is completely in the hands of the government.
  - iii) Cooperative society is incorporated under the Indian Companies Act, 1956.
  - iv) In cooperatives each member is entitled to receive the bonus in the proportion of the business he has done with the society.
  - v) Women cannot become members of a cooperative society.
- 2) Fill in the blanks.
  - i) In cooperative societies, liability of the members is .....
  - ii) To form a cooperative, there should be at least members.....
  - iii) The maximum number in a cooperative society is .....
  - iv) Primary motive of cooperative is .....
  - v) Maximum rate of dividend that can be paid to the members on share capital in a cooperative society is .....

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## 5.6 LET US SUM UP

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Based on ownership there are four basic forms of business organisation: 1) sole trader organisation, 2) partnership organisation, 3) company organisation, and 4) cooperative organisation.

A business which is owned, financed and controlled by a single person is called sole trader organisation. This is most suitable for small business. There is no distinction between the business concern and the proprietor. This form of organisation has advantages from the point of view of control, secrecy, ease and low cost of formation, ease of dissolution and less government regulations. Disadvantages include: the owner's unlimited liability, difficulty in raising capital, limited management expertise, unstable business life and difficulty in attracting qualified employees.

A partnership is an association of two or more persons to carry on as co-owners of a business for profit. Usually there would be a written or oral agreement between partners which specifies the contribution of each partner to the business, the partner's roles, and other major points of agreement. There are various types of partners based on: (a) extent of participation, (b) profit sharing, (c) behavior and conduct exhibited, and (d) liability shared. Partnership organisation can overcome some of the disadvantages of sole proprietorship organisations. Advantages of partnership include: capital, more specialised management, more certainty, greater incentives to key employees, etc. Partnerships suffer from unlimited liability, difficulty in transferring the shares, potential owner conflicts, short length of life, etc. Companies Act 2013, has provided the provision for One Person Company and Small Company.

Limitations of sole proprietorships and partnerships gave rise to company form of organisation. A company is an artificial person created by law, with a distinctive name, a common seal and perpetual succession. Major advantages of company form of organisation include: shareholders' limited liability, transferability of shares, stability of existence, ease of obtaining additional capital, more managerial expertise, etc. Major limitations are cost and difficulty of formation, more government regulations, lack of secrecy, less scope of prompt decision making, etc.

Cooperative form of organisation is a voluntary association of persons who are not financially strong and cannot stand on their own legs. They come together not with a view to get profits, but to overcome the instability arising out of want of adequate financial resources. The underlying objective is self-help and mutual help. Advantages of cooperative form of organisation include: easy formation, limited liability, government assistance, open membership, etc. Disadvantages include: lack of business acumen, absence of mutual interest, lack of secrecy, rivalry among members, etc.

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## 5.7 KEY WORDS

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- Active Partner** : A partner who takes an active part in the operations of the partnership business.
- Chartered Company** : A company which is incorporated under a special Royal Charter granted by the Monarch.
- Company** : An association of persons registered under the Companies Act. It is an artificial person created by law, with a distinctive name, a common seal and perpetual succession of its members.
- Company Limited by Guarantee** : A company having the liability of its members limited by it, memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.
- Company Limited by Shares** : A company having the liability of its members limited by the memorandum to the value of shares held by them.
- Cooperative Organisation** : A voluntary association of persons established under the Cooperative Societies Act.

- General Partner** : A partner of a partnership organisation whose liability is unlimited and also entitled to participate in the management of the business.
- Government Company** : A company in which not less than 51% of the paid-up capital is held by the Government.
- Limited Partner** : A partner whose liability is limited to the extent of the capital contributed by him.
- Joint Hindu Family Firm** : A business firm owned by a joint Hindu family.
- Nominal Partner** : A partner who just lends his name to the partnership firm. He neither invests his capital nor participates in the management.
- Partner** : A person who is the member in a partnership firm.
- Partner by Estoppel** : A person whose conduct and behaviour creates an impression that he is a partner in the partnership firm.
- Partner by Holding Out** : If a member of a partnership firm represents that another person is also a member of the firm, and if such a person does not disclaim the partnership relationship even after coming to know about it, such person is called partner by holding out.
- Partner in Profits** : A partner who shares the profits of the business without being liable for losses.
- Partnership Agreement** : A written or oral agreement entered into by partners specifying the constitutions rules and regulations of the partnership.
- Partnership Deed** : A written partnership agreement which is duly stamped and registered.
- Partnership Organisation** : An association of two or more person, who join together to share the profits of business carried on by all or any of them acting for all.
- Private Limited Company** : A company which by its articles (a) limits the maximum number of its members to 50 excluding its employees, (b) restricts the right to transfer its shares, and (c) prohibits the invitation to the public to subscribe to its shares and debentures.
- Public Limited Company** : A company which is not a private limited company.
- Registered Company** : A company which is incorporated under the Companies Act.
- Sleeping Partner** : A partner in a partnership firm who is not actively associated with the working of the firm.
- Sole Trader Organisation** : One man business in which an individual produces independently with his own capital, skill and intelligence and is entitled to receive all the profits and assume all risks of ownership.



- Statutory Company** : A company established by a special Act of the Parliament or State Legislature.
- Unlimited Company** : A company in which the liability of the members is unlimited.

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## 5.8 ANSWERS TO CHECK YOUR PROGRESS

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- A) 1. (i) unlimited (ii) proprietor/owner (iii) small (iv) one (v) proprietor/owner  
2. (i) False (ii) True (iii) False (iv) True (v) False
- B) 1. (i) 50 (ii) unlimited (iii) sleeping (iv) two (v) partnership deed (vi) partner by estoppel (vii) limited partner  
2. (i) False (ii) False (iii) True (iv) False (v) True (vi) False (vii) False (viii) True
- C) 1. (i) False (ii) True (iii) False (iv) True (v) False (vi) False (vii) True (viii) False
- D) 1. (i) False (ii) False (iii) False (iv) True (v) False  
2. (i) limited (ii) ten (iii) unlimited (iv) self-help and mutual help (v) 9%

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## 5.9 TERMINAL QUESTIONS

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- 1) What do you understand by sole trader organisation? State merits and limitations of the sole trader organisation?
- 2) Partnership organisations emerged essentially because of the limitations and failures of the sole proprietorships. Discuss.
- 3) What is partnership? How does it differ from a joint stock company?
- 4) What is a joint stock company? Explain how it overcomes the limitations of non--corporate form of organisation.
- 5) Discuss the special features of a cooperative form of organisation. How is it different from a company?
- 6) What are the objectives of a cooperative form of organisation? Explain its merits and limitations.

**Note:** These questions will help you to understand the unit better. Try to write answers for them. But do not send your answers to the University. These are for your practice only.

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# UNIT 6    FORMS OF BUSINESS ORGANISATION-II

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## Structure

- 6.0 Objectives
- 6.1 Introduction
- 6.2 Requisites of an Ideal Form of Business Organisation
- 6.3 Comparison of Various Forms of Organisation
- 6.4 Criteria for the Choice of Organisation
  - 6.4.1 Criteria at the time of Starting a Business
  - 6.4.2 Criteria at the time of Expansion
- 6.5 Choice of Form of Organisation
- 6.6 Social Enterprises
- 6.7 Let Us Sum Up
- 6.8 Answers to Check Your Progress
- 6.9 Terminal Questions

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## 6.0    OBJECTIVES

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After studying this Unit, you should be able to:

- discuss the features of an ideal form of business organisation
- compare the forms of business organisation
- outline the criteria for the choice of form of business organisation.

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## 6.1    INTRODUCTION

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You have learnt in Unit 5 that there are four forms of business organisation, viz (i) sole proprietorship, (ii) partnership, (iii) joint stock company, and (iv) cooperative society. You have also learnt about the merits and limitations of each of these four forms.

Sole proprietorship and partnership have the advantages from the point of view of control, secrecy, motivation, ease of formation, and low cost of organisation. But they suffer from the drawbacks of limited resources, limited managerial abilities with unlimited liability. The company form of organisation, on the other hand, has the advantages of more resources, limited liability and diverse managerial abilities.

When you plan to set up a new business, you have to decide which form of organisation is more suitable for the proposed business. For this, you have to critically analyse the suitability of each forms of organisation in the light of the nature of the proposed business. This is a very crucial decision because it determines the power and responsibility of the entrepreneur and the division of profits and losses. Once it is chosen, it is very difficult and expensive to change it. In this Unit, you will learn about the requisites of a good form of organisation, compare the four forms of organisations, analyse the factors influencing the



choice of organisation form, and decide which form is the most suitable in a given situation.

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## 6.2 REQUISITES OF AN IDEAL FORM OF BUSINESS ORGANISATION

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Before we discuss how to select a particular form of business organisation in a given situation, we should know the essentials of an ideal form of organisation. This may help you in the evaluation of each form of organisation in the right perspective and take the final decision about the choice of a particular form more judiciously. The requisites of an ideal form of organisation are as follows:

- 1) **Ease of Formation:** An important factor for preferring a particular form of organisation to another is the ease with which a business can be brought into existence. The comparative ease of difficulty in forming a particular form of organisation mainly depends on three factors: (i) formation expenses by way of registration fee, stamp duty, fees of legal experts, charges involved in the drafting of documents, obtaining licences, etc., (ii) legal formalities, and (iii) procedural delays, etc. Unless it is very essential, it is better to go for an organisation which is easy to form.
- 2) **Scope of raising capital:** The choice of organisation mainly depends on the amount of capital required which is determined by the nature of business and the scale of operations. For example, if you want to open a retail shop in groceries, the amount of capital needed will not be much. But if you want to set up a sugar factory, you may require a large amount of capital. Ideal form of organisation is one which provides scope for raising the amount of capital as and when required.
- 3) **Extent of liability:** You know that the element of risk and uncertainty is prevalent in each business. In view of this, normally, the businessmen prefer limited liability. Obviously, limited liability is considered as an important feature of a good form of organisation. However, a certain amount of risk is also found to be important to provide the needed spur for initiative, drive, and involvement in business. Many times, the absence of such spur leads to weakness, inefficiency and even dishonesty on the part of management personnel.
- 4) **Flexibility of operations:** The form of organisation should be very flexible and adaptable to changing business conditions without much difficulty or complication. For example, if you want to expand your business, diversify or modernise the plant and equipment, the organisation should be able to meet all requirements.
- 5) **Stability and continuity:** Stability and long life of business is desirable from the point of view of owners, employees, and customers. Employees always prefer a stable and continuous employment. If the business is stable, the owner should be able to formulate plans for the future and to make investments paying for a considerable length of time. From the customers' point of view also, regular supply of goods and services is expected to meet their needs. An ideal form of organisation is one which provides reasonable amount of stability to the business.

- 6) **Effectiveness of management:** As you know that the success of any business enterprise depends on the efficiency of management. Managerial efficiency depends on skills, motivation, flexibility, adaptability, etc. It is difficult for an individual to possess all these qualities.
- 7) **Extent of government control and regulations:** If the governmental control and regulations are too many, the enterprise may have to divert a lot of time, money and energy for complying with legal formalities and instructions. In some cases there may be too much interference by the government officials in the day-to-day business of the firm. No doubt, the investors, creditors, and customers trust the business enterprises whose activities are properly regulated by the government. But too much government interference is not favoured by the entrepreneurs because it mars their initiative and disrupts the working of their business.
- 8) **Business secrecy:** In business, it is important to maintain business secrets without leaking them out to competitors. Therefore, a form of organisation which enables retention of business secrets is preferred to the one wherein business secrets are difficult to preserve.
- 9) **Tax burden:** Business taxes GST, excise duty, and customs duty are charged on certain products and services. Hence, such taxes affect all forms alike and they will not affect the choice. But the income tax liability is different from one form of organisation to the other. Naturally, the form of organisation which attracts the minimum amount of this tax liability is considered as an ideal form. From this point of view, company form of organisation is considered to be best because it enjoys a number of tax reliefs which are not available in case of other forms of organisation.
- 10) **Ownership prerogatives:** Some persons have a very strong desire to control the entire business activities themselves and place a great value upon their right of personal leadership. Some persons are desirous of sharing the responsibilities and risks of a business. Some people may want to own a part of the capital without a strong desire to control the affairs of the business. You can also find some persons who are not ready to bear the business risk. An ideal form of organisation takes care of such prerogatives of the owners.

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### 6.3 COMPARISON OF VARIOUS FORMS OF ORGANISATION

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You have learnt that an ideal form of organisation should have the features of easy formation, limited liability, scope to raise enough capital, business secrecy, flexibility, stability in operations, less governmental controls, less tax burden, etc. You know that there are four basic forms of organisations viz., (1) Sole proprietorship, (2) Partnership, (3) Company, and (4) Cooperative society. In the light of the above features identified for an ideal form of organisation, let us now compare the features of these four forms of organisations. With such comparison, probably, we can identify that form of organisation which fulfils all the ideal features. Look at the Table 6.1 and compare the features of the four forms of business organisations.

Table 6.1: Comparative Study of Different Forms of Organisation

S. Basis of Comparison	Sole Proprietorship	Partnership	Private Limited Company	Public Limited Company	Cooperative Organisation
1 Formation	Easiest. No legal formalities required	Quite easy. No rigid legal formalities	Difficult due to legal formalities	Quite difficult due to many legal formalities	Few legal formalities are involved
2 Specific regulation	None	Indian Partnership Act, 1932	Companies Act, 1956	Companies Act, 1956	Cooperative Societies Act, 1912
3 Legal status	No separate legal status	No separate legal status	Separate legal status	Separate legal status	Separate legal status
4 Membership	Single owner	Minimum is 2 Maximum is 50	Minimum 2 and maximum 200	Minimum 7 and no maximum limit	Minimum 10 and no maximum limit
5 Capital	Very limited capital	Limited capital	Larger capital resources	Any amount of capital can be raised	No substantial resources
6 Management and ownership	Owner management	Owner management	Control, risk and ownership generally go together	Complete separation of management from ownership	Not managed by all members
7 Managerial expertise	Very limited expertise	Limited expertise	Scope for expertise	Very wide scope for expertise	Scope for expertise
8 Owner's liability	Unlimited	Unlimited	Limited	Limited	Limited subject to By-laws
9 Basis of profit sharing	Fully enjoyed by owner	Shared by partners as per agreement	Shared by owners in the proportion of shares held	Shared by owners in the proportion of shares held	Volume of business by each member
10 Ownership transfer	At will and relatively easy	Restricted and relatively difficult	Restricted and relatively difficult	At will and very easy	Restricted
11 Business stability	Depends upon the life of owner	Depends upon the life, insolvency, retirement of partners	Perpetual existence death, insolvency of the members does not effect the life	Perpetual existence death, insolvency of the members does not effect the life	Death, insolvency of its members does not effect the life
12 Business secrets	Full secrecy	Secret shared by the partners	Secrets shared by the members	Exposed to public	Exposed to members
13 State regulations	Almost nil	Very little	Considerable regulations	Excessive regulations	Considerable regulations
14 Tax liability	No special income tax	No special income tax	Heavily taxed and income is double taxed	Heavily taxed and income is double taxed	Exemption from income tax
15 Flexibility	It is an elastic organisation. There is no need of written documents	It can be changed only by the consent of all partners. It requires partnership deed which can be changed by the consent of all the partners	It is an elastic organisation	It is an inelastic organisation. Its Memorandum of Association is difficult to change. It can be changed through the permission of the Govt.	It is an inelastic organisation. Its Memorandum of Association is difficult to change, It can be changed through the permission of Govt.
16 Auditing of accounts	Not required	Not required	Compulsory	Compulsory	Compulsory
17 Winding up	At will	At will	Under the Act	Under the Act	Under the Act

If you carefully analyse Table 6.1, you will realise that no single form of organisation is having all the ideal features. You can find each form of organisation having some of these features. Each form is good in some aspects and not good in other respects. For instance, sole proprietorship and partnership forms of organisations are considered good from the point of view of ease of formation, freedom from government regulations, ownership interest, retention of business secrets, etc. But the same features are not prevalent much in company form and cooperative form of organisations. Company form and cooperative forms are ideal from the point of view of limited liability, scope of raising capital, professionalised management, continuity of life, etc. So, it is difficult to treat any one form as ideal in all respects and suitable in all situations.

### Check Your Progress A

1) List the features of an ideal form of business organisation.

.....  
.....  
.....  
.....

2) State whether the following statements are **True** or **False**

- i) An ideal form of organisation is one which has complicated legal formalities at the time of formation. ....
- ii) Unlimited liability is an important feature of an ideal form of organisation. ....
- iii) Organisation should be flexible and adaptable to changing businesses .....conditions.
- iv) Too much governmental control is not ideal. ....
- v) An ideal form of organisation should ensures table and continuous life to the business. ....
- vi) Retention of business secrets is one of the essential features of a good form of organisation. ....
- vii) The form of organisation which attracts more tax burden is desirable. ....

3) Fill in the blanks.

- i) ..... form is the easiest and ..... form is the most difficult in formation.
- ii) Membership of owners is the highest in ..... form and the lowest in ..... form.
- iii) Scope to raise capital is very limited in ..... form.
- iv) Income is exempted from tax for ..... form of organisation.
- v) Owners liability is unlimited in ..... forms.
- vi) Business secrets are maintained in ..... forms.
- vii) State regulations are the maximum in ..... form
- viii) Business secrets are mostly exposed in ..... form

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## 6.4 CRITERIA FOR THE CHOICE OF ORGANISATION

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By comparing the four forms, we realised that none of them is ideal in all respects. Each form of organisation is good in some respects and not good in other respects. It means that looking for one best form of organisation will be like looking for a shirt that fits everybody in the family. Thus, a particular form of organisation which is suitable in one situation may not be suitable in other situations. So, the best form of organisation is one which fulfils the requirements of a particular business in a satisfactory manner. The basic consideration governing the selection is the attainment of the objectives decided upon by the entrepreneur. Since these objectives also vary from one business to the other, no single form of organisation can be considered as the best suited for all kinds of business.

Now let us analyse what considerations help us in making our choice of the form of business organisation. The decision regarding the choice of organisation assumes importance at two stages of business.

- a) At the time of starting a business
- b) At the time of expansion.

### 6.4.1 Criteria at the time of Starting a Business

Choice of a suitable form of business organisation assumes great importance at the time of initiating or launching a new business enterprise because it is the form of organisation which ultimately determines the power and responsibility of the entrepreneur. The choice is dependent on the following factors.

- 1) **Nature of business:** Choice of a suitable form of organisation is dependent on the nature of the proposed business. The organisational requirements are different for different types of business. For example, a big cement manufacturing activity and a retail cement shop cannot have the same form of organisation. Similarly, the form of organisation suitable for a textile mill is not suitable for a tailoring shop.
- 2) **Volume of business:** The expected volume of business also influences the decision about the suitable form of organisation. If the volume of business is small, you need small amount of capital and run less risk. In that case, sole proprietorship may be quite suitable. But if the volume is large, you need more capital and run more risk which a single owner may find it difficult to cope with. So, partnership form or a company form would be considered more suitable.
- 3) **Area of operation:** The area of operation of the business also influences the choice of form of organisation. If the area is limited and confined to a particular locality, the suitable form of organisation may be sole proprietorship. In case the area is widespread, the suitable form may be a joint stock company.
- 4) **Desire for control:** The extent of control and supervision will also determine the choice of organisation. If it is desired to have a direct control over the business operations, a sole proprietorship or a partnership form of business should be adopted. In case if you feel that there is no need for direct control, the company form of organisation is the best.



- 5) **Capital requirements:** The form of organisation will also depend on the extent of financial requirements of the business. A business which requires a small amount of capital can be organised on sole proprietorship or partnership basis. But if the financial requirements are huge, then the joint stock company form of organisation may be preferred.
- 6) **Extent of risk and liability:** You know business operations involve risk. If the promoters of a business enterprise are deterred by the risk involved, they will start the business on the basis of a limited liability. That means they can go for a company. In case they have capacity to bear the risk involved, it can be organised on sole proprietorship or partnership basis.
- 7) **Government regulations:** As you know the governmental controls and regulations are more in company form and cooperative form of organisations compared to the remaining two forms. If you do not want too much government control and regulation, you should choose either sole proprietorship form or partnership form.

### 6.4.2 Criteria at the time of Expansion

Growth is a normal phenomenon in business. When your business is successful, naturally, you may plan to expand it. The expansion programmes may have the following implications.

- i) Need for larger financial resources.
- ii) Need for internal reorganisation and control.
- iii) Need for specialised services like communication, accounting, marketing, etc.
- iv) Increase in governmental controls and regulations.
- v) Increase in tax liability.
- vi) Increase in the problem of control and coordination

In fact, the nature of these problems will depend upon the nature of the existing business and type of expansion programme undertaken. To implement your expansion programme, you can either continue with the existing form of organisation or adopt a new form of organisation. Whatever alternative you choose, it must be able to meet all requirements of expansion. If your existing business is organised as a sole proprietor concern, you can think about employing a manager or taking a partner. In case, it is a partnership firm, you may have to choose between increasing the number of partners or converting it into a private limited company. Similarly, if your existing business is in the form of private company, you have the choice of converting it into a public limited company or not.

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## 6.5 CHOICE OF FORM OF ORGANISATION

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On the basis of the above discussion, we can conclude that the small business like grocery stores, hair dressers, small restaurants and hotels, small auto workshops, stationery shops, confectionaries, bakeries, dry cleaners, shoe manufacture and suppliers, small electric and electronics repair shops, barbers, tailors, etc., are predominantly sole trade organisations. The reasons for preferring

sole proprietorship form of organisation for these types of businesses are abundantly clear. They function on small scale, cater to the needs of a limited market or deal with a restricted number of customers or dealers, and require a very limited capital. Moreover, they require the personalised attention of the owners to deal with a face-to-face situation. The managerial supervision can be tackled easily by the owner himself and the owner generally likes to be his own boss and active manager.

Business on a relatively larger scale is generally organised as partnership firm. Service enterprises like auto workshops, larger restaurants and hotels, large scale retail houses and medium scale industrial organisations are generally organised under partnership form. In these cases, the entrepreneurs would like to pool their capital, skills, experience, etc. as partners of a firm. The internal organisation of such undertakings is looked after by the partners who specialise in a particular activity in the enterprise.

In those enterprises where the risk involved is quite significant and scale of operation is medium, the likely choice will be the private company. Transport undertakings, hire purchase units, finance and leasing companies, medium scale manufacturing companies are generally organised as private limited companies. In these undertakings the requirements of capital are larger as compared to those of a partnership firm.

For large scale business operations, the most suitable form of business organisation is the public limited company. The large scale manufacturing plants, large transport undertakings, engineering and electronic companies, departmental stores, multiple shops, etc., are usually organised on the basis of public limited company. The principal reasons are the necessity of larger capital and the large amount of risk involved.

On the other hand, the cooperative form of organisation is suitable when the interest of a particular segment of society is to be promoted. Thus, the cooperative form of organisation is used largely for consumers, producers, farmers, etc.

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## **6.6 SOCIAL ENTERPRISES**

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The social enterprises have been established for the development of the society. These enterprises have been involved in dealing with the issues of education, training, unemployment, women empowerment, poverty, inequity etc.

According to National Entrepreneurship Policy 2015, The Ministry of Skills and Entrepreneurship, Government of India “Social Enterprises have emerged as important business instruments to address the issues of poverty, unemployment and inequity in Society, through socially oriented business innovations. Social innovation seeks to answer these social problems by offering new products and services which allow the poor to interact with markets as active participants rather than passive recipients”.

It is clear from the policy that :

- i) Social Enterprises have emerged as important business instruments;
- ii) These enterprises have been involved in addressing the issues related to poverty, unemployment and inequity;

- iii) They are committed to the socially oriented business innovations;
- iv) The social innovations may be used to explore answers to the social problems;
- v) They provide new products and services which help in dealing with the problems of the society; and
- vi) The social enterprises primarily perform the social activities, therefore, the society may get an opportunity to interact with the social enterprises. Thus, they may become active participants.

The U.K. Government has defined social enterprise as “Business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profit for shareholders and owners”.

It is clear from this definition that :

- 1) Social objective is the primary aim of the social enterprise;
- 2) The profit of these enterprises are reinvested for the benefit of the society or the business; and
- 3) The social enterprises are not guided by the maximization of profits for shareholders and owners.

According to British Council Survey, 2016, the state of Social Enterprise in India, the most commonly stated objectives of social enterprises in India are : “creating employment (62%) followed by improving health (41%), protecting the environment (40%), addressing social exclusion (40%), supporting agriculture and allied activities (36%), empowering woman (33%), promoting education (32%), addressing financial inclusion (31%) and supporting other organisations (20%)”.

The above activities show that the social enterprises have been contributing for the social development of India. Moreover, the philosophy of social objectives, social commitment, social upliftment as well as reinvestment for the society required to be spread in all parts of the country.

### Check Your Progress B

- 1) List the factors influencing the choice of organisation at the time of starting a business unit.  
.....  
.....  
.....  
.....
- 2) State whether the following statements are **True** or **False**
  - i) Higher the business volume, the lower is the capital requirement  
.....
  - ii) Sole trader or partnership forms are desirable when direct control of business is preferred .....

- iii) Nature of the business does not have any influence on the choice of organisation form .....
  - iv) If the area of operation is very wide, partnership form is ideal .....
  - v) Company form is suitable in case of limited liability is desired .....
  - vi) Raising of capital to an unlimited extent is possible through public limited company .....
  - vii) Government regulations are more in the case of company form of organisation .....
- 3) Put a (✓) mark against correct answer.
- i) Suitable form of business organisation for a very small business is sole proprietorship/ company form.
  - ii) For large scale manufacturing business, suitable form of organisation is partnership/company form.
  - iii) Suitable form of organisation for medium size retail cloth business is partnership/company form.
  - iv) To raise small amount of capital, suitable form is sole trade form/ cooperative form.
  - v) If the risk element is very high, suitable form of organisation is partnership/private limited company.

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## 6.7 LET US SUM UP

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The features of an ideal form of business organisation are: ease of formation, limited liability, scope to raise enough capital, maintenance of business secrecy, flexibility, stability in operations, less governmental controls, less tax burden, higher managerial efficiency, and more ownership interest.

Comparison of the four forms of organisations shows that none of these forms have all the ideal features. Each form of organisation is good in some respects and not good in other respects. Sole proprietorship and partnership forms are ideal from the point of view of ease of formation, governmental controls, ownership interest, business secrecy, and flexibility. Company and Cooperative forms are ideal from the point of view of limited liability, scope of raising capital, managerial efficiency, stability, and continuity of operations.

As none of the four forms is ideal in all respects, the entrepreneur has to choose the suitable form of organisation in the light of the objectives of his business. For choosing a suitable form of organisation at the time of launching the new business, the entrepreneur has to consider the nature of business, volume of business, area of operation, capital requirements, degree of control desired, expected life of business and desired level of governmental regulations. At the time of the expansion, depending on the situation, the entrepreneur can either continue the existing form or adopt a new form of organisation.

Based on the analysis, it is concluded that the sole proprietorship is the suitable form for small business. If business is relatively larger, partnership is the proper form of organisation. Private limited company is ideal for medium sized business and public company is suitable for large scale business. The cooperative form of organisation is suitable when the interest of a particular segment of the society is to be looked after

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## 6.8 ANSWERS TO CHECK YOUR PROGRESS

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- A) 2. i) False (ii) False (iii) True (iv) True (v) True (vi) True  
vii) False
3. i) Sole trader, public limited company  
ii) public limited company cooperative, sole trader  
iii) sole trader  
iv) cooperative  
v) sole trade and partnership  
vi) sole trade and partnership  
vii) public limited company  
viii) public limited company.
- B) 2. (i) False (ii) True (iii) False (iv) False (v) True (vi) True  
(vii) True
3. (i) sole proprietorship (ii) company form (iii) partnership  
(iv) sole trader form (v) private limited company

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## 6.9 TERMINAL QUESTIONS

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- 1) Explain the features of an ideal form of business organisation. Which form can be considered to be an ideal in all respects?
- 2) None of the four forms of business organisations has all the features of an ideal form of organisation. Discuss.
- 3) Explain the factors determining the choice of the form of business organisation.
- 4) You plan to start a business. How would you choose the suitable form of organisation for your business?
- 5) Company form of organisation is the most ideal form for all types of businesses. Discuss.
- 6) A partnership firm has decided to expand its business which requires more capital and expertise. Should it take more partners or convert it into a private limited company. Give your advice with suitable arguments.

**Note :** These questions will help you to understand the unit better. Try to write answers for them. But, do not send your answers to the University. These are for your practice only.



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## UNIT 7 PUBLIC ENTERPRISES

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### Structure

- 7.0 Objectives
- 7.1 Introduction
- 7.2 What is a Public Enterprise?
- 7.3 Features and Objectives of Public Enterprises
- 7.4 Contribution of Public Enterprises
- 7.5 Problems of Public Enterprises
- 7.6 Departmental Organisation
  - 7.6.1 Features
  - 7.6.2 Merits
  - 7.6.3 Limitations
- 7.7 Public Corporation
  - 7.7.1 Features
  - 7.7.2 Merits
  - 7.7.3 Limitations
- 7.8 Government Company
  - 7.8.1 Features
  - 7.8.2 Distinction between Government and Non-government Companies
  - 7.8.3 Merits
  - 7.8.4 Limitations
- 7.9 Comparison of the Forms of Organisation
- 7.10 Let Us Sum Up
- 7.11 Key Words
- 7.12 Answers to Check Your Progress
- 7.13 Terminal Questions

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### 7.0 OBJECTIVES

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After studying this unit, you should be able to:

- describe the meaning, features and objectives of public enterprises
- state the contribution of public enterprises
- identify the problems of public enterprises
- describe various forms of organisation in public enterprises
- describe the features of each form of organisation
- explain the merits of each form of organisation
- evaluate the suitability of each form of organisation.

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### 7.1 INTRODUCTION

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As you know that the business enterprises promoted by private entrepreneur are organised in any of the following three forms: 1) sole proprietorship, 2)

partnership, and 3) joint stock company. But, the forms of organisation in public enterprises are different. In the case of public enterprises there are three forms of organisation: 1) departmental organisation, 2) public corporation, and 3) government company. Look at Figure 7.1 for the forms of organisation in public enterprises. In this Unit, we shall discuss about the features, objectives, contribution and problems of public enterprises. You will further learn the features, merits and limitations of each of these three forms of organisations and evaluate which form is suitable under a given situation.

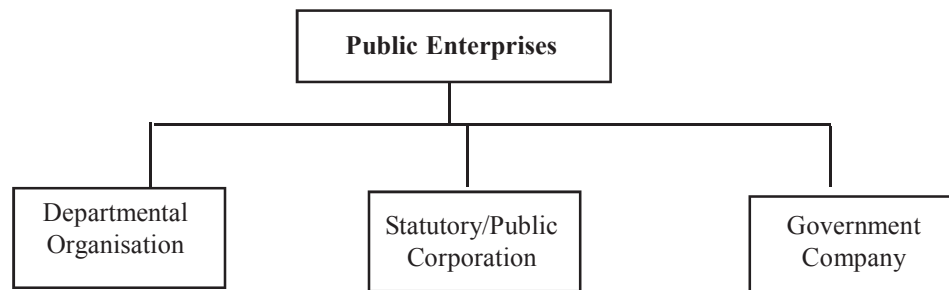


Fig. 7.1: Forms of Organisation in Public Enterprises

## 7.2 WHAT IS A PUBLIC ENTERPRISE?

Strictly speaking the term public enterprise, as a business entity, refers to any industrial or commercial undertaking which is owned and managed by the Central, State or Local government and of which the output is marketed i.e. not supplied free. Thus public enterprises include manufacturing, trading as well as service organisation which are essentially business undertakings.

Public enterprises consist of nationalised private organisations as well as new enterprises promoted under government ownership and control. Life Insurance Corporation, Indian Airlines Corporation, Coal India Ltd., etc. are examples of public enterprises established by nationalising private organisations. Hindustan Machine Tools, Hindustan Antibiotics Ltd., Chittaranjan Locomotive Works, etc., are examples of public enterprises promoted by government.

### Schemes of Public Sector Enterprises

The Government of India has provided more powers to the Boards of the Profit making public enterprises. For this purpose, Maharatna, Navratna and Miniratna schemes have been operationalised. Let us learn them.

**Maharatna Scheme:** The maharatna scheme was initiated in the year 2010. The main objective of this scheme was to empower mega central public sector enterprises to expand their operations and emerge as global giants. There are eight Maharatna central public sector enterprises. These are: i) Coal India Limited ii) Bharat Heavy Electrical Limited, iii) GAIL India Limited, iv) Indian Oil Corporation Limited, v) NTPC Limited vi) Oil and Natural Gas Corporation Limited, vii) Steel Authority of India Limited, and viii) Bharat Petroleum Corporation Limited.

**Navratna Scheme:** The navratna scheme was initiated in the year 1997. The main objective of this scheme was to identify central public sector enterprises that had comparative advantages and to support them in their drive to become

global giants. In this scheme, the Boards have been provided more powers in the areas of i) capital expenditure, ii) investment in Joint Ventures/Subsidiaries, iii) mergers and acquisitions, iv) human resources management, etc. There are sixteen Navratna Central Public Sector Enterprises. These Navratna enterprises are:

i) Bharat Electronics Limited, ii) Container Corporation of India Limited, iii) Engineers India Limited, iv) Hindustan Aeronautics Limited, v) Hindustan Petroleum Corporation Limited, vi) Mahanagar Telephone Nigam Limited and 10 others.

**Miniratna Scheme:** The miniratna scheme was initiated in the year 1997. The Government of India has provided more autonomy and delegation of financial powers to the miniratna enterprises to make them efficient and competitive. There are 74 miniratna central public sector enterprises. The miniratna enterprises have been placed in two categories i.e. category-I and category-II. The miniratna enterprises in category-I are: i) Airports Authority of India, ii) Antrix Corporation Limited, iii) Balmer Lawrie & Co Limited, iv) Bharat Cooking Coal Limited, v) Bharat Dynamics Limited and 54 others. The miniratna enterprises in category-II are: i) Artificial Limbs Manufacturing Corporation of India, ii) Bharat Pumps & Compressors Limited, iii) Broadcast Engineering Consultants (I) Limited, iv) Central Mine Planning & Design Institute Limited, v) Central Railside Warehouse Company Limited and 10 others.

### **Performance of Public Sector Enterprises**

According to the Annual Report (2017-18), Department of Public Enterprises, Government of India, there were 320 central public sector enterprises in India. There were 244 operating enterprises. Remaining 76 enterprises were yet to start operations. Out of 244 operating enterprises, 165 enterprises were running in profits for the year 2015-16. The remaining 78 enterprises were running in losses for the year 2015-16.

### **Disinvestment of Public Sector Enterprises**

According to investopedia.com “Disinvestment is the action of an organisation or government selling or liquidating an asset or subsidiary”. According to Department of Investment and Public Asset Management, Ministry of Finance, Government of India, the salient features of the disinvestment policy are as follows:

- i) Public Sector Undertakings are the wealth of the nation and to ensure this wealth rests in the hands of the people, promote public ownership of Central Public Sector Enterprises CPSEs;
- ii) While pursuing disinvestment through minority stake sale in listed CPSEs, the Government will retain majority shareholding, i.e. at least 51 per cent of the shareholding and management control of the Public Sector Undertakings;
- iii) Strategic disinvestment by way of sale of substantial portion of Government shareholding in identified CPSEs upto 50 per cent or more, alongwith transfer of management control.

## Difference Between Public Enterprise and Private Enterprise

Private enterprises, on the other hand, refer to industrial and commercial organisations which are set up under individual or group ownership within the general framework of regulatory laws and rules of the government. These include: manufacturing and commercial companies, medium and small firms organised as proprietary and partnership concerns.

Private enterprises are primarily motivated by private profit. Public enterprises are governed by public policies framed by government and aimed at maximizing social welfare and upholding public interest. The objectives of public enterprises in India are laid down in conformity with the objectives of the development plans. They are accountable to the government and the parliament or state legislatures regarding the fulfillment of their objectives. Private enterprises are free to set their objectives and to undertake any business activity except those which are illegal. However, private enterprises are also regulated by government controls of different kinds.

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## 7.3 FEATURES AND OBJECTIVES OF PUBLIC ENTERPRISES

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### Features

The main features of public enterprises as distinguished from private enterprises are as follows:

- 1) Public enterprises are owned and managed by the government or agencies set up by the government.
- 2) The whole or major part of the capital required for the public enterprises is provided by government.
- 3) A public enterprise can be organised as a departmental undertaking or as a statutory corporation or as a government company.
- 4) These are governed by public policies laid down by the government in the public interest and are not entirely guided by profit motive.
- 5) Their objectives are laid down in conformity with the development plans. They are accountable to the Parliament or state legislature for their performance and fulfilment of objectives.

### Objectives

It should be clear from the reasons which prompted the growth of public enterprises, that the principal objectives of these undertakings are many. The objectives are outlined below:

- 1) To achieve rapid economic development through industrial growth in accordance with the development plans.
- 2) To channelise resources in the best possible manner for economic growth.
- 3) To secure public welfare and to reduce inequalities in the distribution of income and wealth.
- 4) To ensure balanced regional development of industry and trade.

- 5) To prevent the growth of monopoly and concentration of economic power in a few private hands.
- 6) To control the prices of essential consumer goods in the market to prevent public hardship.
- 7) To mobilise public savings through financial institutions to meet the demands of public and private enterprises in accordance with planned priorities.
- 8) To provide satisfactory employment conditions to the personnel as model employers.

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## **7.4 CONTRIBUTION OF PUBLIC ENTERPRISES**

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Many people argue that if we judge the contribution of public enterprises only in financial terms, we are less than fair to them. There are many other important aspects of their contribution which cannot be ignored. Non-financial gains of public enterprises are diverse and substantial. Some of these gains are as follows:

- 1) Public enterprises have a great deal for the country to emerge as an industrial nation. Today, India is considered to be among the industrialised nations of the world. We are also self-reliant in many major areas of industrial production and most items of consumer goods and services.
- 2) They have helped the industrialisation and development of backward areas.
- 3) They have also assisted the development of backward communities, particularly scheduled castes and scheduled tribes, by providing employment opportunities.
- 4) Expansion of public enterprises have led to the reduction of income disparities. As compared to private enterprises, the salary differential between the lowest and the highest paid employees is much less in public enterprises.
- 5) The constitutional objective of avoidance of concentration of economic power in few hands, has been greatly achieved by the public enterprises. In the absence of these enterprises, economic power would have gone into the hands of a few large and established business houses.
- 6) The dealings of public enterprises with their suppliers, dealers, customers, employees and public at large have a higher level of morality than in the counter part private enterprises.

Thus, we find that public enterprises are an important instrument in implementing the nation's social and economic policies, and their success cannot and should not be measured only in terms of profit.

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## **7.5 PROBLEMS OF PUBLIC ENTERPRISES**

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We have learnt that the government in India is in business in a big way covering varied fields of activity. We also studied about the performance and contributions of public enterprises. Now let us study the limitations of these enterprises.

- 1) Even though public enterprises are often registered as joint stock companies like any other private sector companies, their way of working is not fully



commercial. It is so because these enterprises being close to the government system, often adopt the procedures, practices and attitudes prevalent in government departments.

- 2) The Board of Directors of public enterprises are not fully professional. Often there is no continuity in the job of the top men.
- 3) There is too much job security at all managerial levels below the board and this affects the level of performance in public enterprises.
- 4) The system of reward and punishment in public enterprises more often resembles that in the government than in similar private enterprises.
- 5) Many important and large public enterprises are in areas where technology is difficult and new. And also the location is not always decided from the economic point of view.
- 6) The workers unions are strong and well-organised. So, they are able to extract from these enterprises more than their rightful share.
- 7) Most public enterprises show poor performance due to surplus manpower and low productivity of the personnel, almost at all levels, particularly so at lower levels.
- 8) Public enterprises are very large in size as compared to private enterprises. The complexity of managerial problems increase in geometric progression with increase in size. The public enterprises, by and large, have not been able to adequately cope with their complex managerial and administrative problems.
- 9) Many constraints are also caused due to the public enterprises being subject to the government type audit by the Comptroller and Auditor General of India, and Parliament's scrutiny of their affairs.

So far right answers to many of these problems have not been found. Many expedients and remedies have been tried from time to time, but without much success.

In public enterprises, there are three forms of organisation: i) Departmental organisation, ii) Public Corporation, and iii) Government Company. Let us learn them in detail.

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## **7.6 DEPARTMENTAL ORGANISATION**

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Departmental form of organisation is the oldest form of organising public enterprises. Under this form of organisation, business activities of the undertakings are conducted under the overall control of one of the departments of the government. In other words, when a public enterprise is organised, financed and controlled in much the same way as any other government department, it is known as 'departmental form of organisation'. This form of organisation is generally, chosen for such undertakings which are important from the view point of public interest and national interest. This form is suitable for most of the undertakings which are not run on pure commercial principles. Departmental form of organisation, generally, is suitable under the following situations.

- i) Where the basic purpose of an enterprise is to procure revenue for the government.
- ii) Where the government desires to have firm control over service sectors keeping in view public interest (e.g. posts and telegraph, broadcasting, etc.)
- iii) Where maintenance of secrecy is regarded as a matter of strategic importance (e.g. atomic energy, defence industries, etc.).
- iv) Where projects are in earlier stage of initial planning and require constant efforts and continuous funds that can be provided only by the government.

However, the latest trend seems to favour the participation of private enterprises even in defence industries. For instance, the Bharat Electronic Ltd., which is a state owned undertaking, is given a company form of management. A part of the telecommunication services was converted into two joint stock companies in 1981. One of them is called the Videsh Sanchar Nigam Ltd., which is responsible for the overseas telecommunication service; the other is the Mahanagar Telephone Nigam Ltd., which is responsible for telephone systems in Mumbai and Delhi.

### 7.6.1 Features

The main features of departmental form of organisation are as follows:

- 1) **Overall control rests with the minister:** Under this form of organisation, overall responsibility of management rests with the minister under whose ministry the undertaking functions. The minister, in turn, delegates authority downwards to the various levels of the organisation. Thus, the line type of authority relationship is represented between executives at different levels. In some cases, to manage the day-to-day operations, the government may appoint a Board. The examples of such Boards are the Railway Board, the Postal Services Board, the Telecommunications Board, etc. However, in this form of organisation, the overall responsibility rests with the minister and the minister is answerable to the legislature for the efficient operation of the undertaking.
- 2) **Employees are the civil servants:** The employees in the case of departmental organisation are civil servants. For example, Union Public Service Commission (UPSC) is responsible for the recruitment of gazetted personnel in railways and postal services (which are departmental organisations) as it is for administrative and police service. The terms and conditions of service of the employees are also the same as for the other government employees.
- 3) **Financed through budget appropriations:** The finances of a departmental form of organisation are not independent of the government. They are financed out of the government treasury through the annual budget appropriations and its revenues are paid into the treasury. For example, railways and postal (they are departmental organisations) budgets form part of the government budget.
- 4) **Accounting and auditing systems:** This form of organisation is subject to budget, accounting and audit controls. For this purpose, the undertaking is treated on par with other government organisations.

- 5) **Sovereign immunity:** Being an integral part of the government, it enjoys the sovereign immunity of the state. Therefore, it cannot be sued without the consent of the government.

### 7.6.2 Merits

You have learnt about the meaning and features of departmental form of organisation. Now let us discuss about the merits of this form of organisation.

- 1) **Maximum degree of government control:** This form of organisation lends itself to the maximum degree of government control. Therefore, government can meet its social obligations very effectively.
- 2) **Limited scope to misuse public funds:** As you know, departmental undertakings are managed by the concerned ministry. Hence, the accountability of the enterprise to Parliament is complete. You have also learnt that these undertakings are treated on par with other government departments for purposes of budgeting, accounting and auditing. Therefore, the danger of misuse of the public funds is reduced. In the words of Krishna Menon's Committee 'the accountability of departmental undertakings to Parliament is complete, their management being under the ministry concerned'.
- 3) **Governmental control over economic activities:** It provides an opportunity for the government to secure absolute control of economic activities. The government can freely use departmental undertakings as instruments of its social and economic policy.
- 4) **Multiplies economic progress:** The surplus coming from departmental undertakings increases the revenue of the government. Thus, this surplus can be utilised for the economic progress of the nation and the welfare of the masses.
- 5) **Responsible to Parliament:** A departmental enterprise is responsible to Parliament even for its day-to-day operations. It is not possible for a departmental enterprise to claim certain privileges from Parliamentary scrutiny. For example, if members of Parliament ask questions regarding the appointment or dismissal or promotion of a particular employee, or regarding a particular sale or purchase transaction, it is a matter of day-to-day operations. Such a question can be allowed to be asked of a departmental enterprise but not of a statutory corporation or a government company.

### 7.6.3 Limitations

Departmental form of organisation suffer from the following limitations:

- 1) **Bureaucracy and red-tapism:** You know that the staff of these departmental undertakings are the civil servants. So it is too close to the bureaucratic system of the government where much importance is attached to rules, regulations and precedents for every decision. Therefore, scope for initiative is limited. Normally a business enterprise needs much flexibility and quickness in decision making which you do not find in the departmental form.

- 2) **Suffers from political instability:** These undertakings are generally at the mercy of the political party which is in power. The fate of departmental undertakings also depends on the balance of power between the ruling party and the opposition. Hence there is even a possibility of victimising such undertakings because of political changes and political instability. Thus, these undertakings are subject to political changes and attacks motivated by political considerations.
- 3) **Excessive parliamentary control:** You have learnt that the departmental undertakings are completely answerable to Parliament even for their day-to-day operations. As a result, there is less scope for any initiative and skill in the departmental organisation. Every detail relating to their working are scrutinised and questioned in Parliament and outside. This causes delay in making vital decisions relating to the organisation.
- 4) **Lack of professional expertise:** These undertakings, as you know, are managed by civil servants who often lack business acumen. They are selected and trained altogether for a different purpose. Rigid adherence to formalities and procedures causes delays in decision making which is quite opposed to business principles. Besides, there is no bar on transfers of these officers. This hampers their understanding commitment and responsibility.
- 5) **Absence of competition and profit motive:** Departmental undertakings are run with the objective of service motive. So, the commercial principles which are necessary for their very success are neglected. Further, due to lack of competition there is little incentive to improve their operational efficiency.
- 6) **Financial constraints:** You know that these undertakings are financed through annual budget appropriations made by the legislature and its revenues are paid into the treasury. They are not allowed to raise finances on their own and depend completely on the government. As a result, sometimes, these undertakings suffer due to shortage of funds. Further, these enterprises do not have much flexibility in financial matters, as they are subject to budget, accounting and audit controls.

**Check Your Progress A**

- 1) What are the forms of organisation in public enterprises?  
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.....  
.....  
.....
- 2) What is a departmental form of organisation in public enterprises?  
.....  
.....  
.....  
.....

- 3) State whether each of the following statements are **True** or **False**.
- i) Under departmental form of organisation overall control rests with the managing director.
  - ii) A public enterprise organised under departmental form can raise the capital by public issue of shares.
  - iii) The staff working under departmental form of organisation are the civil servants.
  - iv) In departmental form of organisation, individuals are not allowed to subscribe to the capital.
  - v) Departmental form is suitable when the enterprise is working with profit motive.
  - vi) Departmental form of organisation is not suitable where maintenance of secrecy is regarded as a matter of strategic importance.
  - vii) Departmental form of organisation suffers from red-tapism and bureaucracy.
  - viii) Personnel working in departmental undertakings are not subject to transfer.

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## **7.7 PUBLIC CORPORATION**

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Public Corporation is a corporate body created by the Parliament or State Legislature as the case may be, by a special Act which defines its powers, duties, functions, immunities and the pattern of management. Public Corporation is also known as statutory corporation. The capital is wholly subscribed by the government. It is managed by the management committee constituted according to the provisions of the Act. It is answerable to the Parliament or State Legislature as the case may be.

As stated by Roosevelt, public corporation is an organisation which is clothed with the power of the government but is possessed of the flexibility of private enterprise. Herbert Morrison views a public corporation as a combination of public ownership, public accountability and business management for public ends. Thus the public corporation device is an attempt to combine public interest with the flexibility of operation most prominently found in a company form of organisation working in the private sector. Normally, the public corporations are constituted for any of the following purposes:

- i) To transfer the business of a nationalised undertaking to the corporation.
- ii) To facilitate the acquisition of undertakings belonging to an existing company.
- iii) To promote, develop and operate certain schemes.
- iv) To extend certain social services and utility-services.
- v) To provide for regulation and control of the working and operations of an institution or for other matters connected therewith or incidental thereto.



The development of the public corporation is largely a post-independence phenomenon. The first public corporation was the Damodar Valley Corporation which was established under a Parliament Act in 1948. It is a multi-purpose river project. In the same year, the government set up the Industrial Finance Corporation of India to provide finance for industries in the private sector. In 1953 when the Indian Airlines and Air India were set up, the Air Corporations Act was passed. In 1955 the State Bank of India was established through the State Bank of India Act and the Life Insurance Corporation of India was set up through the Life Insurance Corporation Act of 1956. Thus, we find that whenever the government wants to undertake a commercial activity, it goes to Parliament and gets approval to set up a distinct entity.

It may be noted that it is not necessary that each corporation will have an Act of its own. More than one statutory corporation can also be established under the same act of the legislature. For example, the State Electricity Boards have been established in most of the states under the Electricity (Supply) Act of 1948. Similarly, most of the States have State Financial Corporations set up under the State Financial Corporations Act of 1951.

### 7.7.1 Features

You have studied what a public corporation is? Now let us discuss about the main features of the public corporations.

- 1) **Created by a special Act of legislature:** Public corporation is an autonomous corporate body created by a special Act of a legislature as the case may be. The Act defines the powers, duties, privileges, immunities, relationship to the government department, etc.
- 2) **It is a corporate body:** A corporation, like a joint stock company is a legal entity. It means that a corporation is an 'artificial person' which exists in the eyes of law. Like a living being, it can enter into contracts and can transact any business under its own name. Since it does not have physical existence, it operates through its agents, which is its Board of Directors.
- 3) **Owned by the State:** It is fully owned by the state and the capital is wholly subscribed by the state.
- 4) **Managed by a Board of Directors:** It is managed by a Board of Directors constituted according to the provisions of the Act. The members of the Board represent various interests and are appointed by the concerned public authority.
- 5) **Answerable to legislature:** Public corporation is answerable to legislature (Parliament/ State Assembly) which creates it. The way the corporation would be held accountable is mentioned in the Act. Parliament is not expected to interfere in its day-to-day working. But it can discuss matters of policy and the overall performance of the corporation. Sometimes, however, questions are asked and answered on the floor of the house even though they relate to the day-to-day functioning of a corporation. You may ask why does this happen? Parliament in a democracy is supreme and it is not possible to curtail its freedom. Further, when public enterprises are mismanaged, Parliament cannot be stopped from enquiring into their

performance even though it may involve infringement of a principle agreed to by Parliament itself.

- 6) **Relation with the government:** Even though a statutory corporation is owned by the government, it does not operate as a wing or part of the government. The legal relationship and channels of communication between the government and the corporation are laid down in the Act of its incorporation. For example, the Life Insurance Corporation which is a statutory corporation, would be guided on matters of policy involving public interest as per the directions issued in writing by the Central Government. Thus, the relationship with the government is formal and clear.

In practice, however, there is a lot of informal dealing with the statutory corporations. An example would clarify as to how this happens. Suppose the government wants the Indian Airlines to operate a service between Delhi and Imphal which is not being run by the Indian Airlines because it is uneconomical. Now, under the Air Corporation Act, the government can ask the Indian Airlines to run a service by issuing a written directive. But the government will only suggest the Airlines to undertake such service. If there is a formal order by the government, it may have to meet the loss, if any, suffered by the Indian Airlines in carrying out its orders. In many matters, therefore, the government prefers to remain informal and get things done without owning the responsibility for its actions.

- 7) **Own staffing system:** Although a corporation is owned and managed by the government, its employees are not government servants. The employees are recruited, remunerated and governed by the rules and regulations laid down by the corporation. Their pay and benefits are also different from those of the government servants. Thus, the corporation can have the necessary freedom in regard to its employees in running its business. However, the government closely regulates the terms and conditions of employment of corporations, but that is mainly to maintain uniformity in the pay and benefits received by the employees of the various corporations.
- 8) **Financial independence:** A major source of autonomy of a statutory corporation is its independence in respect of its finances. Unlike departmental form of organisation, a public corporation is not subject to the budget, accounting and audit controls. The corporation shall have its own funds and all receipts of the corporation shall be credited thereto and payments shall be made therefrom. Once the funds are given to a corporation, it manages them on its own. It does not have to go to the Parliament to get its budget approved. A corporation can also borrow money within and outside the country after getting approval from the government.

### 7.7.2 Merits

Public corporation strikes a mid-way between departmentally run public undertakings and the privately owned and managed corporate bodies. It absorbs some of the salient desirable features of both of them to fetch the best of both forms. At the same time, it eliminates some of their major weaknesses also. Let us discuss about the merits of a public corporation form of organisation.

- 1) **Initiative and flexibility:** As it is an autonomous corporate body set up under an Act of legislature, it manages its affairs independently with its

own initiative and flexibility. It experiments in new lines, exercises initiative in business affairs and enjoys the operational flexibility as in private enterprises.

- 2) **Avoids red-tapism:** The evils of red-tapism and bureaucracy associated with departmental form of organisation are avoided. Business functions cannot be carried out efficiently in a government set-up, which is marked by rules, regulations and procedures. Compared with a departmental organisation a public corporation can take quick decisions and prompt actions on any matter affecting its business.
- 3) **Easy to raise capital:** Public corporations are government owned statutory bodies. They can easily raise required capital on their own whenever needed by floating bonds at relatively lower rates of interest. Public also comes forward to subscribe to such bonds since they are safe.
- 4) **Protects public interest:** As you know, compared to a departmental organisation, a public corporation is relatively free from political interference, parliamentary enquiry and departmental checks and controls. Although it has a considerable degree of administrative autonomy, its policies are subject to Parliamentary control. Thus, it ensures protection of public interests. Further, the Board of Directors of the public corporations consists of persons from various fields such as business experts and the representatives of special interests like labour, consumers, etc., who are nominated by the government. Thus, exploitation of any class at the cost of another is ruled out.
- 5) **Works with service motive:** Public corporation avoids the defects of profiteering, exploitation, illegitimate speculation, etc., which are often associated with private enterprises. A public corporation works primarily with service motive and profit earning is only a secondary consideration. Though it works efficiently to show good results in the form of 'surplus,' such surplus must not be the result of exploitation. The surpluses generated by the public corporations are used for the good of the consumers and the community.
- 6) **Secures working efficiency:** It secures greater working efficiency by providing better amenities and more attractive terms of service to its employees which in turn, reduces the labour problems.
- 7) **Secures benefits of large scale economies:** Economies of large scale operations are realised by the virtue of increased size and scale of the business. Further, it is easy to reap considerable economies in management by affecting the integration of several companies under this form. For example, giant government undertakings organised as autonomous units such as, banking, insurance, transport, etc., can secure better management and staff with comparatively lesser costs.

### 7.7.3 Limitations

You have learnt about the merits of public corporation form of organisation. This form of organisation also suffers from certain limitations.

- 1) **Less autonomy:** Compared to departmental form, public corporations enjoy more autonomy. But, in practice, the autonomy of public corporation is closely and systematically controlled by the government even in matters where they are supposed to have freedom. For example, the Food Corporation of India and the Electricity Boards in various States (these are statutory corporations) are of important to the government and to the public at large. But, the Central and State Governments often find it difficult to allow them the freedom which they are entitled to as per their Acts.
- 2) **Inflexibility:** A public corporation is set up by a special Act of legislature. Any change in the objects and powers of the corporation requires an amendment in the Act by the legislator. This tends to make a corporation inflexible and insensitive to changing situations.
- 3) **Clash amongst divergent interests:** As you know, the corporations are owned by the government and are managed by a Board of Directors appointed by the government. When the Board of Directors represent different interests there may be clash of interests. This in turn, may hamper the smooth functioning of the corporation. Sometimes, the directors may abuse their autonomy and authority by indulging in undesirable practices. This would defeat the social objectives of public corporation.
- 4) **Ignores commercial principles:** Public corporations do not have to face any competition. They are neither guided by profit motive nor haunted by the fear of loss. Therefore, there is a possibility of ignoring commercial principles in their working. This may ultimately lead to inefficiency and losses to the corporation. The losses, thus arising are met by the government through subsidies.
- 5) **Excessive public accountability:** You know that the public corporations work with the service motive rather than profit motive. This public accountability of the corporation, sometimes acts as a stumbling block in the operational efficiency of the enterprise.

### Check Your Progress B

- 1) What is a public corporation?

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- 2) List three features of a public corporation.

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- 3) Fill in the blanks.
  - i) For public corporation capital is fully subscribed by .....
  - ii) Public corporation is created by a .....
  - iii) Public corporation is managed by .....
- 4) State whether each of the following statements are **True** or **False**.
  - i) Members of the Board of Directors of a public corporation are elected by the public.
  - ii) Capital of public corporation is partly subscribed by the private entrepreneurs.
  - iii) Public corporations can raise required capital on their own.
  - iv) The employees of a public corporation are government servants.
  - v) The budget of the public corporation is to be approved by Parliament every year.
  - vi) Members of the Board of Directors of a public corporation are nominated by the concerned public authority.

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## 7.8 GOVERNMENT COMPANY

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According to the Indian Companies Act, a government company is a company in which 51 per cent or more of the total paid-up capital is held by the central government or any state government or by many state governments or partly central government and partly by one or more state governments. Any company which is subsidiary of such a company is also considered a government company. Thus a government company is an enterprise wherein government is a predominant shareholder having the bulk of controlling interests. Government company is registered under Indian Companies Act. When the government applied to the Registrar of Joint Stock Companies for setting up a new company, it has to follow all the rules and procedures as are applicable to private persons. Just because the government is getting a company registered it does not get any concession in regard to the formal requirements.

Of late, we come across mixed-ownership companies wherein capital is jointly held by the state and private (Indian or foreign) interests. A government company in which both the government and private (enterprises/individuals) are shareholders, is known as a **mixed-ownership company**. The Government of India has registered and organised a large number of its commercial and industrial undertakings mostly as private limited companies even though their control and regulation actually rests with the government by virtue of its owning majority of shares. But why does the government do like that? Government normally establishes the company form of organisation for the following reasons.

- 1) **Public interest:** Government sometimes acquires shares of the existing private enterprises when they are unprofitable or have become insolvent or are in financial crisis. Government acquires such companies in the interests of the country. Eastern Shipping Corporation and Hindustan Shipyard Ltd., are examples of the companies taken over by the Government of India.



- 2) **Mixed-ownership:** Sometimes, in order to secure capital, technical knowhow, expert guidance, etc., the government may be desirous of starting an enterprise in association with private entrepreneurs. In such situations, the government may set up mixed ownership companies. The examples of mixed-ownership companies are Hindustan Machine Tools, Hindustan Shipyard Ltd., Heavy Engineering Corporation, Hindustan Cables, etc.
- 3) **Industrial promotion:** In order to encourage industrial promotion, sometimes, government may establish some companies. Such companies are not directly connected with any manufacturing activity, but they are expected to bring out commercially feasible projects to be eventually established in private or public sectors. National Industrial Development Corporation, and National Small Industries Corporation are some examples in this category.
- 4) **Promotion of trade or commerce:** Government may also establish some companies to promote trade or commerce. State Trading Corporation, Export Credit & Guarantee Corporation (ECGC), etc., are some examples.
- 5) **Lack of incentives:** The private entrepreneur does not come forward to establish enterprises because of certain risks such as longer gestation period, heavy investment outlay, lack of profit in the initial years of its formation, etc. In such cases the government may establish government companies.

### 7.8.1 Features

The basic features of a government company are the same as those of a statutory corporation. However, there is one major difference i.e., an act of legislature (central/state) is necessary for establishing a statutory corporation while a government company does not require it. This difference has some constitutional implications. You would learn about the distinction between public corporation and government company in this unit later. The other features of the government company are about the same as those of the statutory corporation. Now we shall discuss the features of government company in detail.

- 1) **Created under Indian Companies Act:** Government company is a corporate body, created under the Indian Companies Act, 1956, like any other joint stock company in the private sector. With regard to registration, memorandum, articles, meetings, capital structure, accounts, audit, etc., it is governed by the provisions of the Companies Act. But the government has the authority to exclude or modify certain provisions of the Companies Act by special notifications duly approved by the legislature.
- 2) **It is a corporate body:** A government company is a legal entity. It is an 'artificial person', which exists in the eyes of law. Like a living being, it can file a suit in a court of law or be sued, can enter into contract and acquire property in its own name.
- 3) **Scope for private participation in the capital:** A government company may be wholly or partly owned by the government. In any case, the share of the government is not less than 51%. In case it is partly owned by the government, the private persons (individuals as well as corporate bodies) can also participate in the capital. Thus, there is scope for the private sector to participate in the capital.

- 4) **Managed by a Board of Directors:** It is managed by the Board of Directors. All the directors or the majority of them, depending on the extent of private participation, are appointed by the government. While constituting the Board, the government may give representation to various interests like technocrats, labour, consumers, foreign collaborators, etc.
- 5) **Enjoys financial independence:** Government company can use and reuse the revenue derived from the sale of its goods and services. If necessary, it can borrow money from the financial institutions and the general public.
- 6) **Independent staffing:** Its employees are not civil servants. They are appointed by the company on its own terms and conditions. It regulates its personnel policies according to its Articles of Association.
- 7) **Independent accounting and auditing system:** It is exempted from the accounting and audit laws and procedures applicable to government departments. Its accounting practices are more akin to those of commercial enterprises and its auditors are chartered accountants appointed by the government on the advice of the CAG.
- 8) **Annual reports:** Its annual reports and accounts alongwith the audit reports are to be presented to the legislature, as per the Companies Act.

### 7.8.2 Distinction between Government and Non-government Companies

There are certain differences between a government companies and other joint stock companies called 'non-government companies'. They are as follows:

- 1) **Paid-up capital:** In the case of a government company not less than 51% of the paid up share capital is held by the central government or by the state government or jointly by the central or one or more state governments. There can be any combination of the shares owned by the central and state governments. But the total paid-up capital owned by one or more governments should be 51% or more, to make it a government company. It may be noted that there are a few government companies which have private participation in the equity. In the case of non-government companies, major share of the paid-up capital is held by the private individual.
- 2) **Auditor appointment:** The auditor of a government company is appointed by the government on the advice of the Comptroller and Auditor General of India (CAG). He is also empowered to direct the auditor about the manner and method of auditing. Sometimes, the CAG himself carries out the audit of government companies under the Companies Act. The Auditor of a non-government company is appointed by the General Body of the company.
- 3) **Annual reports:** The annual reports alongwith audit reports of government companies are laid before Parliament if it is a central government company, and before the state legislature in case of a state government company. In case of a non-government company, the audit reports are laid before its General Body.
- 4) **Provisions of the Companies Act:** Central government has the power to exempt any provision of the Companies Act from applying to a government

company except the provisions regarding audit. But, central government has nothing to do with regard to the provisions of the Companies Act relating to a non-government company.

### 7.8.3 Merits

You have learnt about the meaning and features of government company form of organisation in public enterprises. Now let us discuss about the merits of this form of organisation.

- 1) **Easy to form:** Most of the public enterprises in India are in the form of joint stock companies. The main reason for this is the ease with which the government can form a company. Whenever the need arises to take up a new activity, the government can float a new company. It can avoid all the problems of getting a bill passed by the legislature, as is required when a statutory corporation is to be set up.
- 2) **Easy to bring changes in the constitution:** Government favours this form because it is easy to bring changes in the constitution through amendments to Articles. Most of the government companies are fully-owned by the government. As the sole shareholder, the government has all the right to amend the Articles of Association of the company and pass resolution in the meeting, when the need arises.
- 3) **Facilitates taking over a running enterprise:** This form facilitates taking over a running enterprise by the government after securing a majority interest in the equity of the company. For example, after acquiring the equity of the Burmah-shell group of companies, the government changed their name to Bharat Petroleum Corporation Ltd., which now operates as a government company. In the same way, dozens of private sector companies which were taken over by the government are running as government companies, with or without a change in name.
- 4) **Facilitates private participation:** This form of organisation facilitates private participation in the equity of public enterprises. If the government wants, it can easily do so by selling a part of the equity of a government company to the public at large.
- 5) **Easy to transfer ownership:** This form is also helpful in disposing of a public enterprise easily. Once the price at which the shares are to be transferred is decided, the transfer of ownership becomes easy by selling the shares to the private party.
- 6) **More autonomy:** It has almost all the advantages available in the public corporation form of organisation. It has its own charter, autonomy of operations, self-sufficiency in finance, freedom in personnel matters, etc.
- 7) **Flexibility in operations:** As you know, the employees of the government company are not the civil servants. So, the evils of red-tapism and bureaucracy associated with departmental form of organisation are avoided. This enables a government company to take decisions and prompt actions on any matter affecting its business.

### 7.8.4 Limitations

The government company form of organisation suffers from the following limitations:

- 1) **Evades constitutional responsibility:** The government company can be created without specific approval of Parliament. Parliament does not discuss the reasons for setting up a government company or its constitution. Thus it evades constitutional responsibility.
- 2) **Government interference:** Being the sole shareholder in most cases, the government can revise the Memorandum and Articles of Association of a government company, whenever necessary. Thus, the constitution of a government company can be altered without any public discussion but public scrutiny is necessary in the case of a statutory corporation. This may affect the autonomy of the company.
- 3) **Fear of public accountability:** The directors and chief executives of a government company always have the fear of public accountability. As a result, they may not take the initiative in breaking new ground and in entering into new areas of activities.
- 4) **Public criticism:** The performance of a government company is shown in the annual reports of the ministry concerned. These annual reports are placed before the parliament or State Legislature as the case may be. As such, they become public documents exposing the enterprise to the glare of public criticism.
- 5) **Lack of professional management:** As you know, the directors of a government company are mostly appointed by the government. So, these enterprises fail to achieve business efficiency found in similar enterprises in the private sector.

#### Check Your Progress C

- 1) What is a government company?

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- 2) Fill in the blanks.

- i) The auditors of a government company are appointed by the ..... on the advice of the .....

- ii) To become a government company, the minimum percentage of the paid-up capital to be held by the government is .....
  - iii) Most of the public enterprises in India are organised in the form of .....
  - iv) Government company is created under the ..... Act.
  - v) Government company is managed by a ....
- 3) State whether the following statements are **True** or **False**.
- i) The General Insurance Corporation of India is a government company.
  - ii) The government company is a corporate body.
  - iii) The government has the right to run a government company as it likes.
  - iv) All the funds of government companies are always provided by the government.
  - v) A government company is free to employ persons according to its requirements without any reference to government.
  - vi) A company with 51% or more shares owned by the government is a government company.
  - vii) The government can exempt government companies from the application of some of the provisions of the Companies Act.

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## 7.9 COMPARISON OF THE FORMS OF ORGANISATION

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We have already discussed the features and limitations of each of the three forms of organisations i.e., departmental organisation, statutory corporation, and government company. Now let us compare the features of these three forms and evaluate which form is suitable in a given situation. Look at Table 7.1 which summarises the features of all the three forms.

The comparison of the features of the three forms of organisation clearly shows that the accountability to legislature and the government control are maximum in departmental organisation and minimum in government company. In the matters of staffing, financing and day-to-day operations, the departmental organisation has the least autonomy while the company form enjoys the maximum autonomy. Similarly, departmental form of organisation is the least flexible while company form enjoys the maximum flexibility. The main features of the public corporation and government company are about the same. There is hardly any difference in the working of these two forms of organisation. For example, the Life Insurance Corporation of India is a statutory corporation, but the General Insurance Corporation of India is a government company. But both of them function alike in respect of their working and management.



S.No.	Basis	Departmental Organisation	Public Corporation	Government Company
1.	Formation	Created by the government and attached to a particular ministry.	Comes into existence by a special Act of legislature.	Formed by ministry under the Companies Act.
2.	Legal Status	No separate legal status.	It is a separate legal entity.	It is a separate legal entity.
3.	Management	Managed by the concerned ministry of the government.	Managed by the Board of Directors nominated by the government.	Managed by the Board of Directors consisting of members nominated by the government plus the elected shareholders.
4.	Capital	Provided wholly by the government out of budgetary appropriation.	Fully subscribed by the government.	Minimum of 51% by the government.
5.	Scope for Private Participation	No scope for private participation.	No scope for private participation.	Scope for private (national/international) participation in its share capital and hence in its affairs too.
6.	Operational Autonomy	Least or no autonomy. Works as a part and parcel of the government.	Works as an autonomous body within the provisions of the Act. Enjoys considerable degree of autonomy as there is no government interference in day-to-day affairs.	Runs on commercial principles like a private enterprise and enjoys higher degree of freedom from government interference.
7.	Flexibility	Subject to government control completely. Subject to budget, accounting and audit procedures of the government.	Subject to some restrictions by the government. Not subject to budget, audit and accounting procedures of the govt.	More freedom from government control. Not subject to audit budget and accounting procedures of the government.
8.	Public Accountability	Concerned Minister is accountable to the legislature.	Accountable to the public through legislature.	Government and the concerned ministry is accountable to the public.
9.	Operating Finance and Borrowing Powers	Budgetary allocation only. No powers to borrow. Its revenues are paid into the treasury.	Makes own arrangements and enjoys borrowing powers. It has authority to use its revenues.	Makes own arrangements and enjoys borrowing powers. It has the authority to use the revenue.
10.	Staffing and Terms of Service	Employees are the civil servants and governed by civil service code.	Employees are not civil servants. Employees governed by its own contract of service.	Employees are not civil servants. Employees governed by its own contract of service.

The main difference, however, is that the public corporation is established by a special Act of legislature while the government company is incorporated under the Companies Act without referring to legislature. There is scope for private participation in capital and management in the case of government company whereas there is no such scope in a public corporation. Then the company form of organisation is able to evade parliamentary control.

From this relative assessment of the features of these three forms of organisation, it should be obvious that company form of organisation is best suited to industrial and commercial undertakings, while statutory corporations should be preferred in the case of public utility undertakings. To run efficiently the industrial and commercial enterprises must have maximum autonomy of management and manned by professional managers so as to ensure their functioning on business lines. For such enterprises, it is essential that there is least interference from the Ministry or Parliament in their day-to-day affairs. Besides, there should be adequate flexibility with regard to formulation of policy and strategy. With the company form of organisation, these requirements are substantially fulfilled because of the juristic entity of companies and there being no need for getting parliamentary approval for changes in strategy or policies. On the other hand, public utilities are best organised as statutory corporation in view of their monopoly character and the necessity of strict regulation by government.

You will observe that various government organisations often include in their names the words like corporation (State Trading Corporation of India Ltd.), ‘company’ (Hindustan Photofilms Manufacturing Company Ltd.), ‘authority’ (Steel Authority of India Ltd.), and Commission (Oil and Natural Gas Commission). But, there are no legal implications of this. They do not necessarily indicate the form in which they are organised. For example, the word ‘corporation’ is used as part of the names of both the statutory corporations and the government companies. The Life Insurance Corporation of India is a statutory corporation but the General Insurance Corporation of India is a government company. It is, therefore, not possible to distinguish between a statutory corporation and a government company on the basis of the words used in their names.

To some extent, we can distinguish between a statutory corporation and a government company with the word ‘limited’. Normally, the government company carries the word limited as a part of its name. But there are some exceptions even in this case. If a government company is registered under Section 25 of the Companies Act it need not use the word ‘limited’ as part of its name because such companies are established for cultural social or non-commercial purposes only. They do not pay dividends to its members and should apply their income mainly to promote specific objectives. The central government companies in this category are: i) National Research Development Corporation, ii) Indian Dairy Corporation. iii) Trade Fair Authority of India, and iv) Artificial Limb Manufacturing Corporation of India. These companies do not use the word limited in their names. even though they have been incorporated under the Companies Act.

### Check Your Progress D

- 1) Fill in the blanks.
  - i) ..... is created by a special Act of legislature and ..... incorporated under Companies Act.
  - ii) ..... form is closer to bureaucratic system compared to the other forms.
  - iii) The scope for private participation in the capital is there in ..... form.

- iv) ..... form of organisation is subject to budget, accounting and audit procedures of the government.
- 2) State whether the following statements are **True** or **False**.
- i) For all practical purposes there is no difference between a statutory corporation and a government company.
  - ii) Both the statutory corporations and the government companies are corporate bodies.
  - iii) Compared to other forms of organisation, departmental organisation has more financial autonomy.
  - iv) The words ‘corporation and company’ in the name of a public enterprise can indicate different forms of organisation.
  - v) Operational autonomy is more in the case of statutory corporation compared to departmental organisation.

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## 7.10 LET US SUM UP

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The term ‘public enterprise, as a business entity refers to any business undertaking which is owned and managed by the central or state or local government, and of which the output is marketed i.e., not supplied free of charge. These enterprises are governed by public policies framed by government and aimed at maximising social welfare and upholding public interest. They are accountable to the government and the Parliament or state legislatures regarding the fulfilment of their objectives.

The main features of public enterprises are : government ownership and control, contribution of capital by the government, governance by public policies, objectives in conformity with development plans, accountability to legislature, etc. The objective of public enterprises are: rapid industrialisation, channelising resources for development, reduction of inequalities in the distribution of income and wealth, balanced regional development, control of monopoly power and concentration of wealth, check of rise in prices, mobilisation of public savings, provision of satisfactory employment conditions, etc.

There are three forms of organisations in public enterprises: 1) departmental organisation. 2) statutory corporation, and 3) government company.

Under the departmental form of organisation, the enterprise is organised, financed and controlled in the same way as any other government department. The overall control rests with the concerned minister and the minister is answerable to the legislature for its efficient operations. It is financed through annual budget appropriations made by the legislature and its revenues are paid into the treasury. It is subject to budget accounting and audit controls as applicable to other government departments. Employees of this organisation are civil servants.

Departmental organisation has certain advantages. Since its accountability to legislature is complete, government gets maximum degree of control over the operations of these enterprises. Therefore, there is limited scope to misuse public funds. The government can use departmental undertakings as instruments of its social and economic policy. The surpluses coming from these undertakings can be utilised by the government for the economic progress of the nation. These

undertakings suffer from bureaucracy and red tapism, extensive legislative control, political instabilities, lack of professional expertise, lack of flexibility and autonomy in financial matters, and absence of competition and profit motive.

Public corporation is a corporate body created by the Parliament or a State Legislature by a special Act which defines its powers, duties, functions, immunities, and the pattern of management. It is also called 'statutory corporation'. Public corporation is fully owned by the state and the capital is wholly subscribed by the state. It enjoys financial autonomy. It is managed by a Board of Directors nominated by the government. Its employees are not the civil servants. Public corporation is answerable to the legislature which creates it. But the legislature is not expected to interfere in its day-to-day operations.

Public corporation form of organisation has certain merits. Being an autonomous corporate body, it can manage its affairs independently with initiative and flexibility, and can also avoid red-tapism. Since it has financial independence, it can easily raise capital whenever needed. As it works with service motive and answerable to legislature, it protects the public interest and avoids the defects of profiteering, exploitation, illegitimate speculation, etc. It can secure working efficiency and economies of scale. Public corporations suffer from excessive government interference, inflexibility in policy matters, clash of interest among Board members, excessive public accountability and lack of commercialism.

Government company is a corporate body registered under Indian Companies Act in which not less than 51% of the paid-up share capital is held by the central government or any state government or by several state governments or partly by the central government and partly by one or more state governments. Any company which is a subsidiary of such a company is also considered a government company. For establishing a government company, the government need not go to the legislature. In this form of organisation, there is scope for private participation in the capital as well as management. It is managed by the Board of Directors consisting of members nominated by the government and the elected members of the private shareholders, if any. It has financial autonomy and independent staffing system. It is free from auditing, accounting and budgetary controls applicable to departmental organisations.

The major advantage of the government company is that while taking care of all the disadvantages of the departmental form, it provides all the benefits of the public corporation. It is easy to form and also easy to bring changes in its constitution whenever needed. There is scope for private participation in capital and management. It facilitates taking over a running enterprise by the government or transferring the ownership to private entrepreneurs. Being autonomous in financial, staffing and accounting aspects, government company has more operational flexibility. The major limitation of this form of organisation is that it evades parliamentary probe. It also suffers from lack of professional management, government interference, fear of public accountability among top executives, and so on.

The relative assessment of the features of all the three forms indicates that the departmental form of organisation is suitable for such undertakings which are very important from the view point of public interest and national interest. The company form of organisation is best suited for commercial and industrial undertakings, while public corporations should be preferred for public utility undertakings.

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## 7.11 KEY WORDS

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- Autonomy** : In the context of public enterprise, autonomy refers to the management's independence in policy-making and execution of policies without political interference.
- Capital Employed** : Total fixed assets less accumulated depreciation plus working capital. The working capital means all current assets less current liabilities and provision.
- Corporate Body** : An organisation having a legal entity created by an Act of the legislature, or by registration under the Companies Act.
- Departmental Organisation:** A form of organisation where a public enterprise is organised, financed and controlled in the same way as the government department.
- Government Company** : A company registered under the Indian Companies Act in which not less than 51% of the paid-up share capital is held by the central government or any state government or partly by the central government and partly by the one or more state governments.
- Industrial Policy Resolution:** It is a formal decision of the government in the form of a resolution regarding its industrial policy, including the place which the public and private enterprises would have in the economy.
- Mixed-Ownership Company:** An enterprise where capital is jointly held by the government and private interests (Indian or foreign).
- Public Accountability** : Answerability of public enterprises to the public through Parliament or state legislature as the case may be.
- Public Corporation** : An autonomous corporate body created by a special Act of Parliament or state legislature with defined functions and powers.
- Public Enterprise** : Is an industrial, commercial or business activity of the government, where a return on investment is expected.
- Socialist Pattern of Society:** Broadly it means a system in which the benefits of economic development accrue more and more to the relatively less privileged classes of the society and there is an effort to avoid concentration of wealth and to reduce disparities of income.
- The Comptroller and Auditor-general of India** : An authority under the Constitution of India to ensure thorough audit of accounts of government organisations.



## 7.12 ANSWERS TO CHECK YOUR PROGRESS

- A) 3. i) False ii) False iii) True iv) True v) True vi). False vii) True  
viii) False
- B) 3. i) Government ii) Special Act of legislature iii) Board of Directors  
4. i) False ii) False ui) True iv) False v) False vi) True
- C) 2. i) Government, the Comptroller and Auditor-General of India  
ii) 51%  
iii) Joint stock companies  
iv) Indian companies  
v) Board of Directors
3. i) True ii) True iii) False iv) False v) True vi) True vii) True
- D) 1. i) Statutory corporation, government company  
ii) Departmental organisation  
iii) Government company  
iv) Departmental
2. i) True ii) True iii) False iv) False v) True

## 7.13 TERMINAL QUESTIONS

- 1) What is public enterprise? What are its characteristics? How is it different from a private enterprise?
- 2) What are the forms of organisation in public enterprises? Explain the features of each form.
- 3) What is a statutory corporation? Explain its features, merits and limitations.
- 4) What is a government company? List the differences between a government company and a non-government company.
- 5) What are the main features of the government company? How are they different from those of the statutory corporation?
- 6) What is a government company? Explain its features, merits and limitations.
- 7) What is a departmental form of organisation? Give the main features of this form of organisation and comment on the lack of its popularity.
- 8) Compare the company form of organisation with the statutory corporation. Which of the two would you recommend for managing public enterprises and why?

**Note:** These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

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# UNIT 8 INTERNATIONAL BUSINESS: MULTINATIONAL CORPORATION

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## Structure

- 8.0 Objectives
- 8.1 Introduction
- 8.2 Definition of International Business
- 8.3 Importance of International Business
- 8.4 Definition of Multinational Corporation
- 8.5 Why do Firms Become Multinational ?
- 8.6 Features of Multinational Corporations
- 8.7 Recent Trends in Multinational Corporations
- 8.8 Issues and Controversies of MNCs
- 8.9 Indian Perspectives of MNCs
- 8.10 Let Us Sum Up
- 8.11 Key Words
- 8.12 Answers to Check Your Progress
- 8.13 Terminal Questions

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## 8.0 OBJECTIVES

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After studying this unit, you should be able to:

- explain the importance of international business
- discuss why do firms become multinational
- describe the features of multinational corporation
- explain the recent trends in multinational corporation
- describe the issues and controversies regarding multinational corporations
- discuss the Indian Perspectives of multinational corporation

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## 8.1 INTRODUCTION

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In simple term, business as well as related activities carried out beyond the boundary of the country is referred to international business. Multinational Corporations accelerate the process of international business. International operation is an important part of globalisation. The operations of firm in different countries have given birth to the multinational corporations. Multinational corporations are engaged in the international operations of both the goods and services sectors. In this Unit, you will learn the importance of international business, why do firms become multinational? features and recent trends in multinational corporations. You will further learn the issues and controversies as well as Indian perspectives of multinational corporations.

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## 8.2 DEFINITION OF INTERNATIONAL BUSINESS

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You must be knowing that the knowledge is considered as significant economic power of the business enterprise. Most of the business enterprises have been striving for the attainment of the knowledge. How to produce the best product or service suitable to the customer has been the major challenge for the business enterprises. The business enterprises invest significant amount on the research and development activities to find out or discover the new process, product or service. The discovery of the new process may facilitate the business enterprise to operate beyond the boundary of the country. Thus, the research and development, technology, management, investment, production and trade play very significant role in the smooth conduct of international business. In fact, they are the important drivers of international business.

What is international business? In simple term, business as well as related activities carried out between two or more countries is referred to international business. There may be different physical, social, economic, political, legal, ecological environmental and other factors influencing the international business. The detailed understanding of these factors may facilitate smooth conduct of international business.

According to Daniels, Radenbough and Sullivan (2008), “International business is all commercial transactions. private and governmental; sales, investments, and transportation that take place between two or more countries”.

According to Ball Mc Culloch Jr, Geringer, Minor and McNett (2009), “International business is business whose activities are carried out across national borders.” This definition includes not only international trade and foreign manufacturing but also the growing service industry in areas such as transportation, tourism, advertising, construction, retailing, wholesaling, and mass communication.

The above definitions show that international business involves:

- i) All commercial transactions carried out beyond the boundary of the country.
- ii) The transactions may be in terms of investments, production, trade, management, etc. between two or more countries.
- iii) The transactions related to services and other aids to trade between two or more countries.

Thus, international business involves transactions of goods, services, aids to trade and other business activities between two or more countries.

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## 8.3 IMPORTANCE OF INTERNATIONAL BUSINESS

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International business may involve foreign trade, trade of services, aids to trade like transportation, banking, insurance, etc. and other activities involved in carrying out business between two or more countries.

The basis of international business is to be found in the diversity of economic resources in different countries. All countries have not been endowed by nature with the same production facilities. There are differences in climatic conditions and geological deposits as also in the supply of labour and capital. Due to these differences, each country finds it advantageous to specialise in the production of some specific commodities. Such specialisation is facilitated by the exchange of surplus production through international trade. International trade takes place when buyers find foreign market cheaper to buy in and sellers find them more profitable to dispose of their products than the domestic market. Thus, a more effective use of world's resources is made possible through international trade. The importance of international business has been discussed as below:

- i) **Awareness about different countries of the world:** The international business involves business between two or more countries. The business enterprise makes effort to understand all spheres of business operations of the other countries. The firms try to analyse the physical, social, cultural, political, legal, ecological environment, etc. of the foreign country. The firms also evaluate the demand, supply and consumption pattern of other countries. As a result, the firms become aware about various dimensions of the business operations of foreign countries.
- ii) **Facilitates the process of globalisation:** Globalisation involves integration of the world economy. International business and related activities, like technology, management, investment, production, trade, aids to trade, etc. facilitate the international operations of the business. The development of transportation and communication mechanism has been further accelerating the growth of international business. The process of globalisation has been instrumental in bringing the country closer to other country. As a result, the world has been emerging as a global village.
- iii) **Diffusion of technology:** Technology has been revolutionising all areas of business activities. The development of new technology involves huge amount of investment. The large business enterprises may be in a position to invest such a huge amount on the development of new technology. Such enterprises would like to sell the technology to the different parts of the world to earn profit. The international business may facilitate diffusion of technology into different parts of the world.
- iv) **Competitive environment:** International business may facilitate development of competitive environment. When the international firm introduces product in the new market, it may also bring new operations, management, technology, etc. along with the product or service. Considering the business practices of these firms, the local firms of host countries may also like to improve their product, services as well as operations. Thus, the competitive environment may be generated among the firms. As a result of the competition, the customers may get better product or service.
- v) **Harmonious relationship:** International business may be a major force in linking various countries to each other. It promotes harmonious and cordial relationships among all of them. It can lead to world economic integration. This in turn leads to political peace and greater cooperation in countries regarding socio-culture developments.

- vi) **Better use of country's resources:** International business helps in the utilisation of country's resources in the best possible manner. In many cases, domestic industries depend upon foreign markets for the disposal of their production. For example, the jute and tea industries of India are mainly dependent upon export market. Japanese industry depends upon exports for its prosperity. Though the US dependence on foreign trade is not so great. Yet more than 25% of US production of a number of agricultural and industrial production is exported. In many cases the existence of an export market enables the producers to increase their production and thus avail themselves of the economies of large-scale production. Some domestic industries depend upon foreign countries for the supply of capital goods and equipment as also for their supply of raw materials and components.
- vii) **High rate of economic development:** International business leads to rapid economic development and higher rate of growth in national income. In fact, foreign trade was considered as an engine of growth. Many developed countries like the UK, the USA and Japan owe their prosperity to their export of manufactured products. In recent years, many developing countries like Korea, Taiwan, Thailand, Singapore and Hongkong have benefitted a lot by active participation in international business.
- viii) **Stability of prices:** Whenever the price of some commodity tends to increase in a country, it can increase the level of its imports of that commodity to check the rise in prices. Similarly, whenever the price of commodity falls due to a glut in its supply, the trend may be checked by exporting the same. This in turn leads to more or less uniform price throughout the world. Foreign trade could also be utilised to control the nefarious activities of monopolists.
- ix) **Greater availability of goods:** The international business provides opportunity to obtain those goods which it cannot produce or cannot produce as cheaply as other countries. Thus a country's well being is determined to a great extent by the extent to which it participates in international business. Consumers benefit from international business as much as they can purchase from the cheapest source. Indian depends upon foreign countries for a substantial portion of her supplies of edible oils. US consumers depend upon imports for the supply of coffee and sugar while the UK consumers obtain the major portion of their foodstuffs and the entire supply of tea from foreign countries. Foreign trade can also help countries to overcome the adverse effects of famines and crop failure.
- x) **Greater employment opportunities:** Foreign trade leads to an increase in domestic agricultural and industrial production which in turn generates more employment in the country.
- xi) **Reduction in cost of production:** As capital goods and raw materials are purchased from the cheapest sources, the overall cost of production goes down leading to lower prices.
- xii) **Contribution to government revenue:** Most government impose duties on imports and sometimes on exports too. These duties generate substantial revenue for the government.



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## 8.4 DEFINITION OF MULTINATIONAL CORPORATION

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At the outset it must be made clear that very often the term ‘Multinational Corporation’ is used synonymous with the term Transnational Corporations TNCs. There is, however, according to some, a difference between MNCs and TNCs. According to them, MNCs produce commodities/products for domestic consumption of the countries in which they operate. TNCs, on the other hand, produce products/commodities to meet the markets of third countries. This fine distinction is generally not made while referring to either MNCs or TNCs. Thus, in our context, MNC can also be referred to as TNC.

A Multinational Corporation or Transnational corporation is defined as an organisation that owns productive assets in different countries, and has common strategy formulation and implementation across border. It is engaged in international production under the common governance of its headquarters. Factors of production move among units located in different countries. These systems increasingly cover a variety of activities ranging from research and development to manufacturing to service functions. MNCs/TNCs are also increasingly established through mergers between existence firms from different countries or the acquisition of existing firms in the countries by firms from other countries.

Dictionary of International Trade ([globalnegotiator.com](http://globalnegotiator.com)) defined multinational corporation as “A large commercial organisation with affiliates operating companies in a number of different countries. A typically one normally functions with a headquarter that is based in one country, while other facilities are based in locations in other countries”. The analysis of the above definitions show that:

- i) Multinational corporation are primarily large enterprises.
- ii) They operate in many countries.
- iii) They are primarily managed by their headquarter.
- iv) The headquarter is based in one country.
- v) Other operating facilities are based in other countries.

United Nations Conference on Trade and Development ([unctad.org](http://unctad.org)) defined Transnational corporation as “An enterprise, which is irrespective of its country of origin and its ownership, including private, public or mixed, which comprises entities located in two or more countries which are linked, by ownership or otherwise, such that one or more of them may be able to exercise significant influence over the activities of others, in particular, to share knowledge, resources and responsibilities with the others.

The analysis of the above definition shows that:

- i) Transnational or Multinational Corporations operate in more than one country.
- ii) Multinational Corporations are linked by the ownership.
- iii) One entity of Multinational Corporation influence it’s other entity significantly.
- iv) They share knowledge, resources and responsibility with their other entities.

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## 8.5 WHY DO FIRMS BECOME MULTINATIONAL?

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The firms become multinational or transnational due to a number of reasons. The major reasons are:

- i) **To take the benefits of economies of scale:** Once the operations of the enterprise grows and stabilise, the enterprise may be tempted to explore the new markets. The enterprise may realise that there may be more demand of the products or services in the foreign market. In order to meet the requirement of the foreign countries, the enterprise may produce the goods in large quantities. This may facilitate attainment of economies of scale to the Multinational Corporation.
- ii) **To protect themselves:** The firms are exposed to the risks and uncertainties of the domestic business cycle. If they set up operation in another country, they hope to diminish the negative effects of economic swings in the home country.
- iv) **To tap the growing world market:** As a result of globalisation, similar goods and services are produced and distributed by multinational corporation in different parts of the world. Firms want to tap such a growing world market for goods and services.
- v) **Response to increased foreign competition:** Firms become multinational in response to increased foreign competition and to protect world market shares. In order to beat the competitor's strategy, a firm sets up operations in the home countries of competitors.
- vi) **To reduce costs:** Multinational Corporations set up operations close to the foreign customers to reduce costs. By doing so, they can eliminate transportation costs, avoid the expenses associated with having middlemen to handle the product, respond more accurately and rapidly to customer needs and take advantage of local resources. These activities help in reducing the cost of the MNCs.
- vii) **To reduce impact of tariff:** The firms may overcome tariff by serving a foreign market from within. For example, firms producing the goods within the European Union can transport them to any other country in the Union without paying tariffs.
- viii) **To take advantages of technological expertise:** In order to take advantage of technological expertise, firms may manufacture goods in the foreign market. Direct involvement in foreign market brings the company closer to increasing technological developments. They are prepared to respond by acquiring new technology. Thus, they are able to protect their international competitiveness.

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## 8.6 FEATURES OF MULTINATIONAL CORPORATIONS

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The main features of multinational corporation are as follows:

- i) MNCs are normally very large in size as measured by the value of their total sales. The average MNC has billions of US dollars at its total sales value which is often equivalent to more than the national incomes of one, two or three large developing countries. In the eighties, and nineties, however there has been a growth of smaller MNCs from Canada, Japan and the UK. Even the USA has now some small MNCs.
- ii) Many MNCs depend to a large extent on their foreign sales. There has been a steady growth of the share of foreign sales to total sales.
- iii) MNCs are multi-product enterprises that provide them tremendous market power.
- iv) The main strength of MNCs is their command over technology and innovation. They spend sizable amount on research and development (R & D). Most MNCs spend 5-6 percent of their sales value on R & D which amount to billions of dollars. This is the reason for their tremendous market power.
- v) Affiliates of the MNCs are responsive to a number of important environmental forces, including competitors, customers, suppliers, financial institutions and government.
- vi) MNCs draw on a common pool of resources including assets, patents trademarks, information and human resources.
- vii) The affiliates of the MNCs are linked by a common strategic vision. Each MNC formulates its strategic plan so as to bring the affiliates together in a harmonious way.

### **Multinational Corporations from Developing Countries**

The growth of MNCs from developing countries is a relatively new phenomenon. The majority of them are from South Asia, South East Asia and Latin America.

There are certain factors which differentiate them from the TNCs of developed countries.

- The MNCs from developing countries are generally more interested in developing countries although developing countries occasionally establish subsidiaries and joint ventures in developed countries. Most of them, however, are established in export supporting activities.
- In some cases, they have management approaches and technologies better suited to the developing countries context because of their own basic background and orientation to developing countries.
- It is also believed that sometimes, the MNCs of developing countries provide competition to MNCs of developed countries.
- The MNCs of developing countries are less able to internalise their parent/subsidiary transactions.

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## **8.7 RECENT TRENDS IN MULTINATIONAL CORPORATIONS**

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The operations of multinational corporations have been growing. The process of globalisation has further accelerated the growth of multinational corporations.

If you analyse the foreign assets, foreign sales or foreign employment of 100 largest multinational enterprises of the world, you will be able to comprehend the vast magnitude of operations of multinational enterprises across the world.

**Table 8.1: 100 largest MNEs of the World**

<b>Assets, Sales and Employment for the year 2016</b>	<b>Billion of dollars, thousand of employees</b>
<b>Assets</b>	
Foreign	8268
Domestic	4985
Total	13,252
Foreign assets as percentage to total assets	62
<b>Sales</b>	
Foreign	4764
Domestic	2700
Total	7464
Foreign sales as percentage to total sales	64
<b>Employment</b>	
Foreign	9330
Domestic	6993
Total	16,323
Foreign employment as percentage to total employment	57

**Source:** World Investment Report 2017.

Look at the Table 8.1 which shows 100 largest non-financial Multinational Enterprises across the world. As you are aware that the Multinational Corporation operate in two or more countries. They generate assets, sales and employment in many countries. Table 8.1 shows that the foreign assets as a percentage to total assets of 100 largest MNEs of world has been 62 percentage for the year 2016. You may also witness in the table that the foreign sales as a percentage to total sales of 100 largest MNEs of the world has been 64 percentage for the year 2016. Similarly, the foreign employment as a percentage to total employment of 100 largest MNEs of the world has been 57 percentage for the year 2016.

Look at the Table 8.2 which shows 100 largest MNEs from developing and transition economies. The MNEs from developing and transition economies have been also growing. These MNEs have been expanding their operations across the world. The Table 8.2 clearly shows that the foreign assets as a percentage to total assets of 100 largest MNEs from developing and transition economies has been 29 percentage for the year 2015. You may also witness in the table that the foreign sales as a percentage to total sales of 100 largest MNEs from developing and transition economies has been 47 percentage for the year 2015. Similarly, the foreign employment as a percentage to total employment of 100 largest MNEs

from developing and transition economies has been 33 percentage for the year 2015.

**Table 8.2: 100 largest MNEs from developing and transition economies**

Assets, Sales and Employment for the year 2015	Billion of dollars, thousand of employees
<b>Asset</b>	
Foreign	1717
Domestic	4249
Total	5966
Foreign assets as percentage to total assets	29
<b>Sales</b>	
Foreign	1769
Domestic	2011
Total	3780
Foreign sales as percentage to total sales	47
<b>Employment</b>	
Foreign	3954
Domestic	8090
Total	12044
Foreign employment as percentage to total employment	33

Source: World Investment Report 2017.

**Check Your Progress A**

1) What do you mean by international business?

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2) Identify three importance of international business.

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3) Write three features of multinational corporations.

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4) State whether following statements are **True** or **False**.

- i) Firms become multinational in response to increased foreign competition.
- ii) Firms may not overcome tariff walls by serving a foreign market from within.
- iii) The main strength of multinational corporation is their command of technology and innovation.
- iv) MNCs of developing countries do not provide competition to MNCs from developing countries.
- v) Companies move their production centres across the border to derive advantages arising from cheap labour.

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## **8.8 ISSUES AND CONTROVERSIES OF MNCs**

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There is broad consensus that MNCs, besides being technological giants and innovation, are efficient allocators of resources in the world economy. Yet there are a large number of issues on which controversies exist. They are:

- i) MNCs interest and the interest of host countries specially developing ones, in many areas, conflict with each other. MNCs produce products which may not be very essential for host developing countries and thus they divert scarce resources away from production of necessary items.
- ii) MNCs generally dominate high profit oriented consumer sectors monopolising profit in these sectors. This is gained through their market power, promotion, brand name, packages etc.
- iii) MNCs are extremely reluctant to transfer latest technology to the host country, thus making the developing countries depend on them for technology. They also preserve all their important R & D in home countries.
- iv) In order to protect market share, MNCs take recourse to restrictive business practices. These include: tying imports to specific sources of interests to them, conditions imposed on technology transfer, price fixation, restrictions and restrictive use of brands names and trade marks.
- v) Through transfer pricings, MNCs avoid paying taxes to government of host countries and thus transfer resources away from them. MNCs also deprive the partners from host countries of their legitimate profits.
- vi) MNCs do not appoint host countries personnel at higher positions.

- vii) MNCs may create balance of payments problems for the host developing countries through imports and repatriation of huge dividends, royalty, technical and management fees.
- viii) MNCs do not create necessary backward and forward linkages. This failure very often leads to non-industrialisation of host countries.
- ix) MNCs are not necessarily very efficient in their operations. There are cases of MNCs incurring huge losses.
- x) MNCs increase their dominant power through mergers and acquisitions thus preventing competition.
- xi) MNCs have a tremendous capacity to influence the policies of home governments and international organisations. This capacity enables them to promote national and international policies to their advantage at the cost of interest of many countries, specially the developing ones.

### **The Home Country Perspectives**

While home countries generally promote their MNCs, there are certain aspects of their operations, which attract adverse comments even from home countries.

- I) MNCs divert resources away from their home countries.
- II) MNCs establish production centres in those countries where cheap labour is available thus creating unemployment in the home countries.
- III) MNCs also often violate environmental conditions by establishing industries in many countries where environment regulations are lax. This leads to (a) global environment problems and (b) import of environmentally hazardous goods.

The supporters of MNCs argue that the above criticisms are exaggerated and not based on adequate evidence. Very often they refer to the economic development of countries such as Malaysia, Thailand and some Latin American countries as proof of the beneficial effect of MNCs. In any case, the eighties and nineties are considered to be a period of cooperation between governments and MNCs.

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## **8.9 INDIAN PERSPECTIVES OF MNCs**

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India followed a restrictive foreign direct investment policy till 1990. Even then a number of MNCs operated in India either through collaboration with Indian enterprises taking minority shares holdings or through their own subsidiaries. Many of them had even dominated some consumer industries with nearly 60-70 per cent of market share. Since many MNCs found that India's domestic market was large, they persisted to operate within the framework of the Indian policies, though the policies were considered very restrictive.

Since 1991, after the government of India liberalised the Foreign Direct Investment (FDI) policy, the country has emerged as an important market for serious considerations of MNCs. Large MNCs like Philips, Union Carbide,

Unilever, Glaxo, Boots, Welcome, Coca Cola, pepsi, IBM, Brooke Bond, ITC are operating in India and many of them are diversifying into a large number of consumer industries. International Banks are also showing interest in the Indian economy. The free entry of MNC is, however, still subject to some concern in Indian industry and political circles. Indian industry fears that too much of liberalisation of FDI policy will adversely affect the operations of the domestic enterprises. Therefore, many of them are seeking level playing fields for them. Some political parties are wary about the domination of MNCs on Indian economy. While this debate is never-ending, it can be concluded that MNCs will increasingly come to India. But their primary pre-occupation, one can envisage, would be to exploit the growing domestic market. Indian enterprises should learn the technology and management skills of MNCs and compete with them.

### **Indian Companies Operating Overseas**

During the last more than one and a half decades since liberalisation, many Indian companies are moving into multinational operations. ONGC Videsh, Reliance, WIPRO, Tatas, Ranbaxy, Dr. Reddy's Laboratories, Infosys, Wipro, Aditya Birla, Mahindra & Mahindra, Bharat Forge, Amtek auto, Asian paints, Essel propack, Sundram Fasteners, and BPL, etc. are some of the better known Indian MNCs.

### **Check Your Progress B**

- 1) Distinguish between MNEs of world and MNEs of developing and emerging economies.

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- 2) State whether following statements are **True** or **False**.

- i) The percentage of foreign assets as percentage to total assets of 100 largest MNEs of the world has been 62 percent for the year 2016.
- ii) The percentage of foreign sales as percentages to total sales of 100 largest MNEs from developing and transition economies has been 47 percent for the year 2015.
- iii) MNCs are not reluctant to transfer of technology to host country.
- iv) MNCs create necessary backward and forwards linkages.
- v) MNCs violate environmental conditions by establishing industries in many countries where environmental regulations are lax.

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## 8.10 LET US SUM UP

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International business involves transactions of goods, services, aids to trade and other business activities between two or more countries. The importance of international business includes: awareness about different countries of the world, facilitates the process of globalisation, diffusion of technology, competitive environment, harmonious relationship, better use of country's resources, high rate of economic growth, stability of prices, greater availability of goods, greater employment opportunity, reduction in costs of production, contribution to government revenues. etc.

Multinational corporations are defined as the companies which have subsidiaries and affiliates in a large number of countries, with central control and with an objective of global profits maximisation. The Multinational Corporations are huge companies measured in terms of their sales turnover, assets and employment. They are multi-product technology intensive companies and technology ownership is their core strength. However, lately, medium sized MNCs are also gaining importance. MNCs normally dominate the markets of products which they are producing.

The major reasons for firms to become international are: to take the benefits of economies of scale, to protect themselves, to tap the growing world market, response to increased foreign competition, to reduce costs, to reduce impact of tariff and to take advantages of technological expertise.

The features of multinational corporations include: large size, large foreign sales, multi-product enterprises, command over technology and innovation, responsive to environmental forces, common pool of resources, and common strategic vision for affiliates.

The analysis of 100 largest MNEs of the world shows that the foreign assets as percentage to total assets has been 62 percent for the year 2016. Similarly, the foreign sales as percentage to total sales has been 64 percent for the year 2016. As far as employment is concerned, the foreign employment as percentage to total employment has been 57 percent of the total employment for the year 2016. The MNCs from developing & transition economies also have significant foreign assets, sales and employment.

The issues and controversies of MNCs involve : conflict of interest , high profit orientation, reluctant to transfer of technology, recourse to restrictive business practices, resort to transfer pricing, do not appoint host countries personnel at higher position, may create balance of payments problem for host country, do not create necessary backward and forward linkages, may incur losses, mergers and acquisition strategy, may influence host country's government, etc.

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## 8.11 KEY WORDS

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- Home Country** : Country of origin of the parent company.
- Host Country** : An independent nation state where MNC establishes its subsidiary or affiliate.
- Intra-Firm Trade** : Trade between subsidiaries, branches and affiliates of the same TNC.

**Market Failure** : When the response of the market does not satisfy the expectations of a corporation.

**Market Power** : Strength or capacity of a MNC to dominate a market.

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## **8.12 ANSWERS TO CHECK YOUR PROGRESS**

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A 4. i) True ii) False iii) True iv) False v) True

B 2. i) True ii) True iii) False iv) False v) True

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## **8.13 TERMINAL QUESTIONS**

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- 1) What is international business? Discuss the importance of international business.
- 2) What is MNC? Why do firms become multinational?
- 3) Describe main feature of MNCs.
- 4) Describe the recent trends in the world as well as in developing and transition economies in various developments pertaining to MNCs.
- 5) Discuss the issues and controversies related to multinational corporations.
- 6) Discuss the main advantages and disadvantages of MNCs operations for the host country and the home country.

**Note:** These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.



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## **SOME USEFUL BOOKS**

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Basu C. R. (2017), Business Organisation and Management, Mc Graw Hill India.

Tulsian. P.C. (Recent Edition), Business Organisation and Management, Pearson.

Gupta C.B. (2018), Business Organisation and Management, Sultan Chand and Sons.

Singh B. P. and T. N. Chhabra, Business Organisation and Management, Dhanpat Rai and Co.



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