CHAPTER 5

Forms and Formation of Business Enterprise

LEARNING OBJECTIVES

After studying this chapter, you should be able to :

- identify the different forms of business enterprises;
- explain the features, merits and limitations of each form of business enterprise;
- examine the factors to be considered for selecting a suitable form of organisation;
- analyse the factors to be considered for setting a business;
- examine the scope for setting small business.

5.1 Introduction

Every business entity adopts some form of business organisation to carry out business activities. For the private sector in India (i.e., business run by private individuals) the forms of business organisation/enterprise are the following:

- Sole proprietorship;
- Joint Hindu Family Business;
- Partnership;
- Cooperative Society;
- Company.

In this chapter we shall discuss various aspects of different forms of business organisation, their relative advantages and limitations, as well as the scope of setting up small business enterprises.

5.2 Sole Proprietorship

A business owned, managed and controlled by a single individual is known as a sole proprietorship organisation. The individual is referred to as the sole proprietor and is responsible for all business decisions. She/he has ownership of all business resources. All profits earned belong exclusively to her/him and all losses incurred are to be borne by her/him. In running the business, however, she he can take the help of his family members and also employ persons as assistants or manager. Legally the business and the individual are the same, in the sense that the sole proprietor is personally liable for all the debts that are incurred in the course of business. In the case of trading firm, the sole proprietor may also be referred to as *sole trader*. Most small concerns adopt this form of business organisation because of its several merits.

5.2.1 Features of Sole Proprietorship

The features of sole proprietorship are mentioned below:

(i) Individual ownership: The business is owned by a single individual.

(ii) Risk bearing: The proprietor is the sole beneficiary of all rewards/ profits. Likewise, if there are losses, she/he alone has to bear them. Thus, she/he alone bears the risk of the business venture.

(iii) Unlimited liability: In the case of business losses, if the business assets are not sufficient to meet all business liabilities, the proprietor may have to sell his personal property to pay off the liabilities.

(iv) Freedom of operation: There is minimum government regulation and the proprietor enjoys substantial freedom of operation in a sole proprietorship concern.

(v) Control: The proprietor is the sole owner of the firm and has full control over it. Even if she/he appoints a manager, she/he retains the control of the business.

5.2.2 Merits of Sole Proprietorship

The merits of sole proprietorship are as follows:

(i) Ease of formation and closure: A sole proprietorship organisation is easy to form. There is hardly any legal formality involved in setting up this type of organisation. It is not governed by any specific law. The business activity should be lawful, comply with the rules and regulations laid down by local authorities, and obtain the necessary license if any. Also, the business can be closed whenever the proprietor desires.

(ii) Flexibility of operations: In a proprietor business, all decisions are made by a single person. There are no delays and the business can quickly adapt itself to the changing environment. This provides flexibility to the business.

(iii) Sole beneficiary of profits: The profits earned in course of business belong only to the sole proprietor. There is a direct relation between effort and reward. This motivates him to work hard.

(iv) Suitability for small-scale operations: The sole proprietorship form is generally, adopted for small-scale business and where personal attention to details is required. Further, where the capital outlay is small and restricted to one's own savings, sole proprietorship concern is the appropriate form of organisation.

5.2.3 Limitations of Sole Proprietorship

Sole proprietorship form of organisation suffers from certain limitations which are :

(i) Unlimited liability: The sole proprietor is personally liable for all business obligations. For payment of business debts, her/his personal property can be used if the business assets are insufficient.

(ii) Limited access to capital: The sole proprietor has limited scope for raising capital. His own funds may be insufficient for expansion. This reduces the scope for business growth.

(iii) Limited managerial skills: Business skills are required in many areas. The lack of knowledge and managerial ability of the sole proprietor in all fields is another factor which limits the prosperity and growth of the business.

(iv) Lack of continuity: The business is dependent on a single individual. If that individual falls ill or becomes insane or insolvent, the business gets destabilised. And if he dies, the business may come to an end.

To conclude, sole proprietorship is a popular form of business organisation in India. It is particularly suited to meet the requirements of small business establishments. The local grocery store, small beauty parlours, tailoring units, and small factories are mostly organised as sole proprietorship concerns.

5.3 Joint Hindu Family Business (JHF)/Hindu Undivided Family Business (HUF)

The joint Hindu family business refers to a business which is owned by the members of a joint Hindu family. It is also known as Hindu undivided family business. This form of organisation exists under Hindu law and is governed by the law of succession. The joint Hindu family form is a form of business organisation in which the family possesses some inherited property. The inheritance of the property is among the male members. The share of ancestral property is inherited by a member from his father, grandfather and great grandfather. Thus, three successive generations can simultaneously inherit the ancestral property. For purposes of running a joint Hindu family business, only male members are entitled who are referred to as coparceners. The oldest member is known as the *Karta.*

5.3.1 Joint Hindu Family Business

The important features of the joint Hindu family business are as follows:

(i) Membership by birth: Membership of the joint Hindu family business is automatic by birth of a male child. It is not created by an agreement between persons.

(ii) Management: The management vests in the *Karta*, the eldest member of the family. However, the *Karta* may associate other members of the HUF to assist him.

(iii) Liability: The *Karta* has unlimited liability, i.e., even her/his personal assets can be used for payment of business dues. Every other coparcener has a limited liability upto his share in the HUF property.

(iv) No maximum limit: There is no restriction on the number of coparceners of the HUF business. However, the membership is restricted to three successive generations.

(v) Minor members: A male child at the time of birth becomes a coparcener. Thus, an HUF does not restrict membership to minors.

(vi) Unaffected by death: The HUF business continues even after the death of a coparcener including the *Karta*. The next senior most surviving male member of the HUF becomes the *Karta*. However, it may come to an end if all the members notify that they are not members of the joint Hindu family.

5.3.2 Merits

Merits of joint Hindu family business are mentioned below:

(i) Economic security and status to the members: The joint Hindu family business provides members a sense of security and belonging because of the financial stake they possess in it. It also gives them status in society while dealing with others.

(ii) Continuity of business: The business has a continuity about it. It is not affected by death or lunacy of members, including the *Karta*. Till such time that the members jointly do not decide to terminate it, the business continues to exist.

(iii) Family pride: Members are likely to work with dedication, loyalty and care, because the work involves the family name. The business is not only an economic unit but also a matter of family prestige.

5.3.3 Limitation

The joint Hindu family business has the following limitations:

(i) Unlimited liability: The *Karta* is personally liable for all business obligations. For payment of business debts, his personal property can be sold if the business assets are insufficient.

(ii) Limited access to capital: The *Karta* has limited scope for raising capital. Her/his own funds may be insufficient for expansion. This reduces the scope for business growth.

(iii) Karta too powerful: An incompetent *Karta* may ruin the business since all business decisions are taken by her/him.

This form of business organisation is perhaps the natural economic extension of the joint Hindu family. It serves to provide economic security and status to members. It continues to have an important place in Indian business.

5.4 Partnership

Partnership is an association of two or more persons who agree to jointly pursue a business activity. They pool their managerial and financial resources for the purpose. *Partnership is the relation between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all.*

5.4.1 Features of Partnership

The features of partnership are outlined below:

(i) Agreement: There must be an agreement between the partners to form a partnership. The agreement may be oral or written.

(ii) Business: A partnership may undertake any lawful business activity, which may consist of trade, profession or industry.

(iii) Sharing of profits: In a partnership firm, partners are entitled to profits which implies sharing of losses as well unless otherwise agreed.

(iv) Number of members: There must be at least 2 members. A partnership may have a maximum of 20 members and in the case of banking business, a maximum of 10 members.

(v) Agency relationship: Each partner is an agent because she/he has the capacity to bind other partners by his acts. She/he can also be similarly bound by the actions of other partners.

(vi) Liability: The liability of partners is unlimited as in the case of sole proprietorship. Partners are individually and collectively liable to creditors of the firm. Hence, the creditors have a right to recover their dues from the private property of one or all partners when the assets of the firm are insufficient.

(vii) Ownership and control: Normally, every partner has a right to take part in the management of the business. Hence, the rights of ownership and control are jointly held by the partners.

(viii) Non-transferability of share: No partner can transfer her/his share in the partnership to any other person. She/he may, however, do so with the consent of all other partners.

(ix) Registration: To form a partnership firm, it is not compulsory to register it. However, if the partners so decide, it may be registered with the Registrar of Firms. There are several advantages of registration which have been discussed later.

(x) Duration: The partnership firm continues at the will of the partners. Legally a partnership comes to an end if any partner dies, retires or becomes insolvent. However, if the remaining partners agree to work together under the original firm name, the firm will not be dissolved and the business will be continued after settling the claim of the outgoing partner.

5.4.2 Types of Partnership

According to the nature of agreement among partners, there can be three types of partnerships as follows:

(i) Partnership at will: Such a partnership exists at the will of the partners. That is, it can be brought to an end whenever any partner gives notice of her/his intention to do so.

(ii) Particular partnership: A particular partnership is formed for undertaking a particular venture. It comes to an end automatically with the completion of the venture.

(iii) Partnership for a fixed duration: Such a partnership is for a fixed period of time say for a period of 3 years, 5 years or any other duration.

5.4.3 Types of partners

The various types of partners found in partnership firms are as follows:

(i) Active partners: Partners who take active part in the conduct of day-to-day business of the firm are called active partners. These partners carry on business on behalf of the other partners.

(ii) Sleeping or dormant partners: Sleeping or dormant partners are those who do not take active part in the management of the business. Such partners only contribute capital to the firm and are bound by the activities of other partners. However, they have a share in the profits and losses of the business.

(iii) Others: Active and sleeping partners are, as a matter of fact, the full-fledged partners, i.e. they share in profits and losses of the business and are liable for its dues. However, there are other types of partners also who may be associated with the partnership directly or indirectly. They are not full-fledged partners. Such partners may include the following:

(a) **Nominal partners:** Nominal partners are those who do not have interest in the business but lend their name to the firm. They do not make any capital contribution, and are not entitled to take part in management, but are liable, like other partners, to third parties. Such partners generally, have a pecuniary interest (like a share in the profits) in lending their name to a firm. However, in certain cases they may not have any pecuniary interest in doing so. For example, a reputed industrialist may, without any profit motive, lend her/his name to a firm run by her/his family members.

(b) **Partner by holding out:** If a person by her/his words or conduct holds out to another that she/he is a partner, she/he will be prevented from denying that he is not a partner. The person who thus, becomes liable to third parties to pay the debts of the firm is known as a partner by holding out.

5.4.4 Minor Admitted into the Benefits of Partnership

A minor is a person who has not attained the age of 18 years. Since a minor is not capable of entering into a valid agreement, she/he cannot become partner of a firm. She/he may, however, be admitted to the benefits of an existing partnership.

It is clear from the preceding discussion that partners can be of three categories: (i) those who share in the profits and losses of the business and assume liability of the business debts (like active partners, dormant partners and nominal partners); (ii) those who share in profits only (like minor partners); and (iii) those who assume liability without sharing in the profits of the business (like partners by holding out).

5.4.5 Merits of Partnership

A partnership firm has the following merits :

(i) Easy to form: A partnership is easy to form and inexpensive to establish.

(ii) Pooling of skills: Partners can provide skills and knowledge in different areas and can work towards greater profitability and growth of the firm.

(iii) Larger financial resources: The partnership firm can greatly increase the pool of capital available to the business. This helps in expanding business and earning higher profits.

(iv) Sharing of risks: The risks of running a business are shared by two or more persons. This emboldens partners to undertake riskier projects that are more profitable.

5.4.6 Limitations of Partnership

Limitations of partnership firm are as follows:

(i) Unlimited liability: Unless otherwise specified, all partners have unlimited liability. In case of two partners where one by virtue of mutual agreement has a limited liability, the other necessarily has unlimited liability. Usually, all partners individually have unlimited liability. But in special cases at least one partner has unlimited liability.

(ii) Uncertainty of continuity: The continuous existence of a partnership firm is uncertain. Retirement, insolvency, insanity, bankruptcy, death of any partner, terminates the partnership. Moreover, a partner can demand the dissolution of the firm, and thereby bring it to an end.

(iii) Non-transferability of ownership: A partner cannot transfer her/his share to another person if he so wishes. She/he can do so only with the consent of all other partners. This may make it difficult for her/him to withdraw from the arrangement.

(iv) Scope for conflicts: Partnerships are jointly owned and managed by all the partners. If partners adopt rigid attitudes, there is scope for disharmony and conflict, which may be to the detriment of the firm.

Partnerships are an ideal form of business organisation when mutual trust and complementary skills are present amongst partners. Wholesale merchants, chartered accountancy firms, and small and medium sized factories are commonly organised as partnerships.

5.4.7 Partnership Deed

As stated earlier, to enter into a partnership, partners have to agree to do so. The agreement may be written or oral. Although, the law permits oral agreements, it is advisable to have a written partnership agreement. This is to avoid disputes by clearly defining the terms of mutual agreement. This written agreement is referred to as the partnership deed.

The partnership deed normally contains the following clauses:

(i) Name of the firm;
(ii) Name and addresses of partners;
(iii) Nature of business;
(iv) Place of business;
(v) Capital contributed by each partner;
(vi) Profit sharing ratio;
(vii) Duties, powers and obligations of all partners;
(viii) Preparation of accounts and their auditing;
(ix) Whether interest is payable on capital and rate applicable;
(x) Whether interest is payable and drawings, and rate applicable;
(xi) Whether interest is payable on loan provided by partner, and rate applicable;
(xii) Whether salary is payable to partners;
(xiii) Method of solving disputes;
(xiv) Provisions regarding dissolution.

5.4.8 Registration of the Firm

Registration of a partnership firm is not compulsory. But an unregistered firm suffers from certain disabilities. These disabilities make it virtually compulsory for a firm to get registered. A partnership firm may be registered at any time that is, at the time of formation or at any time during its existence. A partnership firm desiring registration applies to the Registrar of Firms in prescribed form along with the registration fee. The application should state the following:

(i) Name of the firm;
(ii) The principal place of business of the firm;
(iii) The name of any other place where the firm is to carry on business;
(iv) Date of admission of the partners in the firms;
(v) Names and permanent addresses of the partners;
(vi) Duration of the firm.

The application must be signed by each partner. Changes in the above particulars have to be communicated to the Registrar. The certificate of registration is a reliable evidence and a conclusive proof of the existence of the firm.

Consequences of Non-Registration: An unregistered firm suffers from the following serious disabilities:

(i) A partner of an unregistered firm cannot file a suit against the firm or any other partner for enforcing his rights arising out of the contract;

(ii) An unregistered firm cannot file a suit against any third party for the recovery of claims;

(iii) Such a firm also cannot file a suit against any partner.

5.5 Cooperative Organisation

A cooperative form of business organisation is different from other forms of organisation. It is a voluntary association of persons for mutual benefit and its aims are accomplished through self help and collective effort. The main principle underlying a cooperative organisation is mutual help, i.e., each for one and all for each. A minimum of 10 people are required to form cooperative society. To be called a cooperative society it must be registered with the Registrar of Cooperative Societies under the Cooperative Societies Act. The capital of a cooperative society is raised from its members by way of share capital. It can also obtain additional resources by way of loans from the State and Central Cooperative Banks.

A cooperative society has much in common with partnership. Yet there are differences between the two types of organisation. In a partnership mutual benefit is restricted to partners only, but in a cooperative society it extends to its member as also the public. For example, in a consumer cooperative store or a cooperative credit society, the benefits are available to the members as well as the general public. Besides, partnership requires the existence of some business activity whereas a cooperative may be formed whenever individuals have common needs which are difficult to fulfil singlehanded. Also, registration is optional in the case of partnership but it is compulsory for a cooperative society.

5.5.1 Types of Cooperative Societies

Cooperative societies may be classified into different categories according to the nature of activities performed by them. The main types of cooperative societies are:

(i) Consumers' Cooperative Societies;

(ii) Producers' Cooperative Societies;

(iii) Cooperative Marketing Societies;

(iv) Cooperative Credit Societies;

(v) Cooperative Farming Societies;

(vi) Cooperative Housing Societies.

(i) Consumers' cooperative societies: These are organised by consumers to eliminate middlemen and to establish direct relations with the manufacturers or wholesalers. These societies are formed by consumers to ensure a steady supply of goods and services of high quality at reasonable prices. It purchases goods either from the manufacturers or the wholesalers for sale at reasonable price. The profit if any, is distributed among members as dividend in the ratio of capital contributed by members and also as bonus in proportion to the purchases made by them.

(ii) Producers' cooperative societies: Such societies are formed to help the members in procuring inputs for production of goods or services. These societies generally, provide raw material, tools and equipment and other common facilities to its members. This helps them to concentrate their attention on production of goods. The society provides inputs to the members and takes over their output for sale to outsiders. The basis for distribution of bonus is the goods delivered for sale by each member.

(iii) Cooperative marketing societies: Such societies are voluntary associations of small producers, who find it difficult to individually sell their products at a profit. The main purpose of such a society is to ensure a steady and favourable market for the output of its members. The output is pooled together and sold at the best price. The sale proceeds are distributed in proportion to the contribution of the members to the pool. Marketing cooperatives eliminate middlemen and ensure honest trading practices in weighing, measuring and accounting.

(iv) Cooperative credit societies: Such societies are formed to provide financial help in the form of loans to members. The funds of these societies consist of share capital contributed by the members and the deposits made by them and outsiders. The funds are used in giving loans to needy members on easy terms. Thus, the members are protected from the exploitation of moneylenders, who charge very high rates of interest. Another important purpose of credit cooperatives is to encourage the habit of thrift among their members.

(v) Cooperative farming societies: In cooperative farming societies, small farmers join together and pool their resources for cultivating their land collectively. Their object is to achieve economies of large scale farming and maximising agricultural output. Such societies are particularly important in the case of countries such as India, where agriculture suffers from excessive sub-division and fragmentation of land. Cooperative farming makes it possible for members to use and irrigation facilities in order to achieve higher modern tools and equipments, good seeds, fertilisers production.

(vi) Cooperative housing societies: They are formed to provide residential accommodation to the members. They undertake the purchase and development of land and/or construction of houses/flats on the land. Some housing cooperatives provide their members with necessary loans at low rates of interest to build houses. These societies are gaining popularity in big cities.

5.6.2 Characteristics of Cooperative Organisation

The main characteris-tics of cooperative societies are :

(i) Voluntary association: In cooperatives, the membership is voluntary. Anybody having a common interest is free to join a cooperative society. The member can also leave the society anytime after giving proper notice.

(ii) Equal voting rights: In a cooperative society, the principle of one man one vote is adopted. A member has only one vote irrespective of the number of share(s) held by him. Thus, a cooperative society is run on democratic principles.

(iii) Separate legal entity: A cooperative society is required to be registered under the Cooperative Societies Act. Registration provides it a separate legal entity. Its existence is quite different from its members. The death, insolvency or lunacy of a member does not affect its existence. It can sue and be sued in its own name. It can make agreements as well as purchase and sell property in its own name.

(iv) Service motive: A cooperative society is based on the service motive of its members. Its main objective is to provide service to its members and not to organise profits. Earning profit is the most important objective of other forms of business organisation. It is not so in the case of cooperatives.

(v) Distribution of surplus: Out of the profits of the cooperative, members are paid dividend and bonus. The bonus is given according to the volume of business transacted by each member with the cooperative society. For example, in a consumer cooperative society, bonus is paid in proportion to the purchases made by members during a year. In a producers cooperative the value of goods delivered for sale forms the basis of distributing bonus.

5.6.3 Merits of Cooperative Organisation

The cooperative form of organisation offers the following advantages:

(i) Easy to form: A cooperative society is a voluntary association and may be formed with minimum of ten adult members. Its registration is very simple and can be done without much legal formalities.

(ii) Open membership: Membership in a cooperative organisation is open to all having a common interest. A person can become a member at any time she/he likes and can leave the society by returning her/his shares without affecting its continuity.

(iii) Democratic management: A cooperative society is managed in a democratic manner. It is based on the principle of one man one vote. All members have equal rights and can have a voice in its management.

(iv) Limited liability: The liability of members of a cooperative society is limited to the extent of capital contributed by them. They do not have to bear personal liability for the debts of the society.

(v) Stability: A cooperative society has a separate legal existence. It is not affected by the death, insolvency, lunacy or permanent incapacity of any of its members. It has a fairly stable life and continues to exist for a long period.

(vi) Economical operations: The operation of a cooperative society is quite economical due to elimination of middlemen and the voluntary services provided by its members.

(vii) Government patronage: Government gives all kind of help to cooperatives, such as loans at lower rates of interest and relief in taxation.

(viii) Other benefits: Certain non-economic benefits are also derived by members through cooperatives. Credit cooperatives, for instance, promote habits of thrift and producers' cooperative encourage joint activity among members.

5.6.4 Limitations of Cooperative Organisations

As against the above mentioned advantages of cooperatives the following limitations and drawbacks of this form of organisation must also be noted:

(i) Limited capital: Cooperatives are usually at a disadvantage in raising capital because of the low rate of return on capital invested by members.

(ii) Inefficient management: The management of a cooperative society is generally, inefficient because the managing committee consists of part-time and inexperienced people. Qualified managers are not attracted towards a cooperative on account of its limited capacity to pay adequate remuneration.

(iii) Absence of motivation: A cooperative society is formed for mutual benefit of the group and the interest of individual members are not fully satisfied. There is no direct link between effort and reward. Hence, members are not inclined to put in their best efforts in a cooperative society.

(iv) Differences and factionalism among members: Once the initial enthusiasm about the cooperative ideal is exhausted, differences and group conflicts arise among members. Then, it becomes very difficult to get full cooperation of the members. The selfish motives of members begin to dominate and service motive is sometimes forgotten.

(v) Rigid rules and regulations: Excessive government regulation and control over cooperatives affect their functioning. For example, a cooperative society is required to get its accounts audited by the auditors of the cooperative department and to submit its accounts regularly to the Registrar. These regulations and controls may adversely affect the flexibility of operations and the efficiency of management in a cooperative society.

5.7 Company

The company form of organisation is considered to be most suitable for organising business activities on a large scale as it does not suffer from the limitations of capital and management of other forms of organisation. The sole proprietorship, partnership and cooperative organisations are not capable of undertaking large scale activity due to lack of adequate capital and limited managerial abilities. In a company organisation those problems can be easily overcome. It has the advantage of attracting huge capital from the public due to the limited liability of members. With adequate capital it can also employ trained and experienced managers to run the business activities efficiently.

A company is defined as a voluntary association of persons having separate legal existence, perpetual succession and a common seal. As per the definition, there must be a group of persons who voluntarily agree to form a company. Once formed the company becomes a separate legal entity with a distinct name of its own. Its existence is not affected by change of members. It must have a seal to be imprinted on documents whenever required. The capital of a company consists of transferable shares, and members have limited liability.

5.7.1 Features of a Company

The following are the chief characteristics of the company form of organisation:

(i) Compulsory registration: A company has to be registered under the Companies Act, 1956. With out such registrations, no company can come into existence.

(ii) Distinct legal entity: A company is regarded as a legal entity separate from its members. Thus, a company can carry on business in its own name, enter into contracts, buy, sell and hold property, sue and be sued.

(iii) Artificial person: A company is the creation of law and has a distinct entity. It is, therefore, regarded as an artificial person. The business is run in the name of the company. But because it is an artificial person, its functions are performed by the elected representatives of members, known as directors.

(iv) Perpetual succession: A company has continuous existence, independent of its members. Death insolvency, or change of members does not affect the life of a company. The common saying in this regard is that *members may come, members may go but the company goes on for ever.* The life of the company can come to an end only through the prescribed legal procedure of winding up.

(v) Common seal: Since a company is an artificial person, it has no physical existence. The activities of the company are carried through a group of natural persons elected by its members (called directors). Every company must, therefore, have a common seal with its name engraved on it. Anyone acting on behalf of the company must use the common seal to bind the company. Thus, the common seal serves as the equivalent of the signature of an artificial person.

(vi) Limited liability: The liability of the members of a company is limited. It is limited to the extent of capital agreed to be contributed. Beyond that amount, the members cannot be personally held liable for payment of the company's debts.

(vii) Transferability of shares: The capital of a company is divided into parts called shares. Normally, the shares of a company are freely transferable by its members. However, transferability is restricted in the case of private company, although it is permitted.

5.7.2 Merits of a Company

The important advantages of a company organisation are as follows:

(i) Collection of huge financial resources: The biggest advantage of a company organisation is that it has the ability to collect large amounts of funds. This is because a company can raise capital by issuing shares to a large number of persons. Shares of small value can be subscribed even by people with small savings. Availability of necessary funds makes it possible for a company to undertake business activities on a large scale.

(ii) Limited liability: Another advantage of the company form of organisation is the limited liability of members. With the liability of members limited to the value of their shares, a company is able to attract many people to invest in shares. It is thus, in a position to undertake business ventures involving risks.

(iii) Free transferability of shares: A company permits its members to transfer their shares. Free transferability of shares provides liquidity to the member's investment. Thus, if a member needs cash he can sell his shares. Or, she/he can use the same amount to buy shares of another profitable company. It enables profitable companies to attract funds away from the less profitable ones.

(iv) Durability and stability: A company is the only form of organisation, which enjoys continuous existence and stability. The funds in vested in a company by the shareholders cannot be withdrawn until it is wound up. Also, change in the company's membership does not affect its life. As a result of this, a company undertakes projects of long duration and attracts people to invest in the business of the company.

(v) Growth and expansion: With the large resources at its command, a company can organise business on a large scale. Once the business is started on a large scale it gives the company strength to grow and expand. This is because of high profits which accrue from the economies of large scale organisation and production.

(vi) Efficient management: Since a company undertakes large scale activities, it requires the services of expert professional managers. Competent managers can be hired by a company because it commands large financial resources. Thus, efficient management is more easily ensured in a company organisation.

(vii) Public confidence: A company enjoys great confidence and trust of the general people. Companies have to disclose the results of their activities and financial position in the annual reports. These reports are available to the public. It is on the basis of the annual reports and other information that investment is made in companies.

(viii) Social benefits: Apart from the benefits mentioned above a company organisation also offers the following social benefits:

(a) Democratisation of management: In the company form of organisation, management of business is entrusted to the elected representatives of shareholders, that is the directors. As a result of democratic management the business of a company is more likely to run in the best interest of the majority of shareholders.

Reliance Emerges as No. 1 Amongst All Indian Business Houses

The Reliance Group: It has emerged as No. 1 in market capitalisation, net worth, assets and profits amongst all Indian Business Houses at the end of the millennium according to a study of performances of Indian Business Houses. The study data for other groups have been sourced from the Centre for Monitoring Indian Economy (CMIE) database.

Largest market capitalisation: The market capitalisation of the Reliance Group, which represents the wealth of its shareholders, stands at Rs 47652 crore. This is Rs 5939 crore higher as compared to the next group on the list.

Largest wealth distributor: Reliance Group is also responsible for creating the most wealth for its public shareholders. Reliance has a large base of 5 million investors, and has shared the wealth liberally with its public shareholders. At the close of the millennium the wealth created by the Reliance Group for the public at large, exceeds Rs 33000 crore. Groups and companies, which have their market caps surging in the recent past, have most of their equity concentrated in the hands of a few promoting shareholders. On the other hand, Reliance Group has continued to lead in its effort of democratisation of capital.

Largest net worth: Reliance leads the Indian Business Houses in terms of net worth at the end of the millennium. Its present net worth stands at Rs 19884 crore, which exceeds that of the next group by Rs 3190 crore. Reliance Group's net worth represents more than 30 per cent of the collective net worth of the top 10 net worth groups.

Largest assets: Reliance Group has the largest assets among all the Indian Business Houses. Its total assets are over Rs 55000 crore. Reliance Group's gross fixed assets and net fixed assets at Rs 39533 crore and Rs 31582 crore are also the largest among all Indian Business Houses at the end of the millennium.

Source : Website of Reliance Industries

(b) **Dispersal of ownership:** Since a large number of persons are associated with a company as members, its ownership is widely held. Thus, the benefits of the company's operations are distributed among a large section of people.

(c) **Assumption of social responsibilities:** Large companies often undertake and contribute to social welfare activities by making donations to schools and colleges, developing rural areas, running healthcare institutions, and so on.

5.7.3 Limitations of Company Organisation

The following are the chief limitations of a company organisation:

(i) Lengthy and expensive legal procedure: The registration of a company is a longdrawn process. A number of documents are to be prepared and filed. For preparing documents, experts are to be hired who charge heavy fees. Besides, registration fees have also to be paid to the Registrar of Companies.

(ii) Excessive government regulations: A company is subject to

Reliance Group

Highest profits: In the year 1998-99, Reliance Group has recorded an operating profit of Rs1978 crore, which is more by Rs 571 crore from the next group. This is the highest operating profit among all the Indian Business Houses for the year 1998-99. Reliance's net profit for the year 1998-99 stands at Rs 1792 crore, which is the highest net profit recorded by an Indian Business House for the same period. The Reliance Group net profit is around Rs 250 crore higher than that of the nearest group. For the half-year ended September 1999, Reliance has recorded a net profit of Rs 1184 crore, which makes it the No. 1 group in terms of half-yearly net profit at the close of the millennium.

Major growth in post liberalisation era: The Reliance Group has been able to capitalise on the opportunities thrown up by the globalisation of the Indian economy, starting from mid 1991 onwards. The Reliance Group has successfully met the challenges of liberalisation and achieved a major part of its growth in the post liberalisation era. The group's sales has recorded a compounded annual growth rate of 26 per cent, growing from just below Rs 3000 crore in 1991-92 to over Rs 15000 crore in 1998-99. The group net profit has grown even faster at a compounded annual rate of around 41 per cent per annum, from Rs 163 crore to Rs 1792 crore over the same period. Similarly, the Reliance Group's net worth has increased by over 10 times to over 19000 crore, and the group's total assets have grown by over 11 times to more than Rs 55000 crore between 1992 and end 1999. This growth has been achieved despite intense competition from global majors, regional economic crisis, downturn in domestic economy, and a sharp cut in import duties on Reliance's major products from 110 per cent in 1993 to 30 per cent in 1999.

Source : Website of Reliance Industries government regulations at every stage of its working. A company has to file regular returns and statements of its activities with the Registrar. There is a penalty for non-compliance of the legal requirements. Filing returns and reports involving considerable time and money is the responsibility of the company. All this reduces flexibility in operations.

(iii) Lack of incentive: The company is not managed by shareholders i.e., owners but by directors and other paid officials. Officials do not have investment in the company and also do not bear the risks. As such, they may not be as much motivated to safeguard the interests of the company as the shareholders i.e., owners would have been.

(iv) Delay in decision-making and action: In large companies, decision-making and its implementation is a time consuming process. This is obviously because individual managers are unable to take decisions on their own. They may have to consult others which may take a lot of time. Similarly, after decisions are taken, they have to be communicated to people working at various levels of the organisation. This further delays the implementation of already delayed decisions.

(v) Conflict of interest: A company generally, has many groups involved in its operations. So long as the interests of these groups do not clash with each other they work for the good of the organisation. But sometimes, individual and group interests become difficult to reconcile. For instance, the sales manager may be interested in the quality of products to satisfy customers and increase sales, but the production manager may be more concerned with maximum production without regard to the product quality. In such a situation, the business is bound to suffer in course of time unless there is a reconciliation of the conflicting viewpoints of the two managers.

(vi) Oligarchic management: The company management may seem to be fully democratic, but in actual practice, it is the worst form of oligarchy i.e., control by a small group of persons. People who are once elected as directors of a company adopt various means to get themselves re-elected over and again. Such individuals often exploit the company for personal interests rather than working in the interest of shareholders.

(vii) Speculation: In speculation, profits are sought to be made by manipulating price of shares without actually holding shares. A company organisation provides scope for speculation in shares by the directors. Because directors have knowledge of all information about the functioning of the company, they can use it to their personal advantage. For example, directors may sell or buy shares knowing that prices will decline or go up because of low or high profits. As a result of this, innocent shareholders may suffer loss.

(viii) Growth of monopolistic tendencies: A company because of its large size has the tendency to grow into monopoly so as to eliminate competition, control the market and charge unreasonable prices to maximise profits. The larger the size of a company, the greater is the possibility of it acquiring monopoly power.

(ix) Influence government decisions: Big companies are generally, in a position to influence government officials to make decision in their favour. This is because such companies have large financial resources and are in a position to bribe even high officials.

From the preceding discussion it is clear that the company form of organisation is best suited to those lines of business activity which are to be organised on a large scale, require heavy investment of capital with limited liability of members. That is why enterprises producing steel, automobiles, computers and other high technology products are generally, organised as companies.

5.7.4 Types of Companies

Companies may be classified as private company and public company.

(i) Private company: A private company is one which:

(a) has a minimum of 2 and a maximum of 50 members excluding past and present employees;
(b) restricts the right of members to transfer its shares;
(c) does not invite the public to subscribe to its shares, or debentures;
(d) does not invite the public to subscribe to its deposits;
(e) the minimum paid up capital is one lakh rupees (this amount is subject to change from time to time).

All these restrictions must be continuously observed by a company to be called a private company. Such a company can manage its affairs with a minimum of two directors only. It must include the word *private limited* as a part of its name.

A private company is an ideal form of organisation for those who wish to run a business without associating a large number of members and at the same time deriving the benefit of limited liability. This form of organisation enables a small group of persons to control the management of the company without the risk of displacement by any large shareholding group.

(ii) Public company: A public company is one which:

(a) has a minimum of 7 members and no limit regarding the number of members;
(b) does not restrict the right of its members to transfer its shares;
(c) is not prohibited from inviting the general public to subscribe to its shares and debentures;
(d) is not prohibited from inviting the general public to subscribe to its public deposits;
(e) has a minimum paid up capital of five lakh rupees (this amount is subject to change from time to time);

Concept of Subsidiary Company

A company is a subsidiary of another if:
the other company controls the composition of its Board of Directors, or
the other company holds more than 50 per cent of its equity share capital or
it is a subsidiary of a third company which itself is a subsidiary of the controlling company. For example, if company B is the subsidiary of company A, and company C is the subsidiary of company B, then company C shall be the subsidiary of company A.
The equity share holding pattern of XYZ Private Ltd. is as follows:
Fifty one per cent of shares held by PQR Ltd.
Forty nine per cent of shares held by the public.

Thus, XYZ Private Ltd. is infact a public company in accordance with requirement (f) above.

(f) is a private company, which is a subsidiary of a public company, it follows, therefore, that a private company, which is a subsidiary of a public company, will be treated as public company.

5.7.5 Privileges of Private Company

A private company is entitled to certain privileges. A few of the important ones are as follows:

(i) Number of members: A private company can be formed with only two

Distinction Between Private and Public Company

Characteristic	*Private Company*	*Public Company*
Number of members	Minimum 2, maximum 50 (excluding past and present employees)	Minimum 7, maximum no limit
Number of directors	Minimum 2	Minimum 3
Invitation for public subscription to shares debenture and deposits	Public offer not permitted	Invitation to public permitted
Transfer of shares	Transfer of shares restricted	Free transfer of shares allowed
Index of members	Not compulsory	Compulsory
Legal formalities	Exempt from many legal formalities regarding prospectus, certificate of commencement of business, quorum, etc.	Not exempt from such legal formalities.
Minimum paid up capital	Rs 1 lakh	Rs 5Lakh

members, whereas at least seven members are required to form a public company. This makes its formation easier.

(ii) Number of directors: A private company needs to have only two directors while a public company must have three directors.

(iii) Index of members: A private company does not need to keep an index of its members which is absolutely necessary for a public company

(iv) Loans to directors: A private company is not required to take permission from the government while giving loans to directors, as is required in case of a public company.

(v) Legal formalities: A private company is exempt from certain legal formalities like issue of prospectus, getting certificate of commencement of business, minimum subscription, quorum etc. which are necessary in case of a public company.

8.7.6 Deemed Public Company

Prior to an amendment in the law in 2000, there was a category of companies referred to as deemed

A Survey, the Only One of Its Kind, Ranks India's Largest Private Companies in the Private Sector with Some Surprising Results

Today over a quarter million companies are public limited. Yet some of the world's largest corporations have remained unlisted for centuries. The $49.4 billion Cargill Inc. for example, funded in 1865, is the largest private corporation in the US. So is the $ 20 billion consulting firm Pricewaterhouse Coopers, the $15.3 billion food processing major Mars, the $15.1 billion construction company Bechtel Group and the $5.1 billion apparel company Levi Strauss.

Some claim that there is not much to debate. Listed companies have greater access to capital (and, therefore, superior chances of growing), they are better managed, thanks to considerably higher levels of corporate governance, and they are, perhaps, ennobled by the fact that they share their wealth with others. As evidence, the proponents of widely-held companies point to the fact that the world's largest corporations are always public companies.

The compulsion of not listing or not going public also remain strong. Many promoters are not sure investors would adequately value the champion of the unlisted, Adi Godrej: It makes no sense listing companies where the companies do not require additional funds for expansion, or where the company may have significant assets other than (those required for) their normal business, which the stock market may not sufficiently value. His companies Godrej Appliance (Rank 17; Revenues: Rs 810.2 crore), Godrej Appliances (Rank 20; Rs 731.1 crore) and Godrej Agrovet (Rank 62; Rs 336.2 crore) are among the list of top 100 unlisted companies in India.

Source : Business World

Nirma Consumer Care

For the FMCG major Nirma Consumer Care, the rationale for not going public is not ease of operations, but the ability to bear risk. The group's present, Nirma, set up by chairman Karsanbhai Patel in 1969, went public as late as 1994 (the Patels still own 82 per cent of the equity). But, Nirma's Rs 1,552-crore (Rank 7) subsidiary Nirma Consumer Care, which owns the distribution network, is still unlisted. Nirmas's reasons were: "We decide it (going public) on the basis of requirement of capital and risk bearing capacity. When the risk is so big that one does not want to bear it on his own, it's better to go public."

Source : Business World

public companies. Such companies were registered as private companies. Yet they were considered as public companies by the existing law. Thus, a private company automatically became a public company if:

(i) its shareholding pattern involved members of the public;
(ii) its turnover was high enough to warrant public interest;
(iii) it employed public money.

A private company became a public company (known as a deemed public company):

(a) Where 25 per cent or more of the paid-up share capital of the private company was held by a public company (or a deemed public company).
(b) Where the private company held 25 per cent or more of paid up share capital of a public company.

The Top 25 Private Companies in the Private Sector in India

1. Tata Sons
2. Hyundai Motor India
3. Jet Airways (India)
4. Citi Bank NA
5. Gitanjali Gems
6. LG Electronic India
7. Nirma Consumer Care
8. Gujarat Powergen Energy Corp
9. Bennett, Coleman and Company
10. Kundan Rice Mills
11. Tractors and Farm Equipment
12. Samsung India Electronic
13. Bharat Aluminium Company
14. Cargill India
15. Yamaha Motor Escorts
16. Hero Cycles
17. Godrej and Boyce Mfg. Co.
18. Redington (India)
19. Abn-Amro Bank N.V.
20. Godrej Appliances
21. Allanasons
22. Concorde Motors
23. Automotive Manufactures
24. Parle Products
25. Deutsche Bank

Source : Business World

(c) Where the average annual turnover of the private company for 3 consecutive financial years was Rs 25 crore.

(d) Where the private company invited deposits from the public.

A deemed public company was a special type of public company. It was not treated as a public company in all respects. It could retain some features of a private company. However, in the present legal structure deemed public companies do not exist. Following the amendment, a private company does not automatically become a public company on account of shareholding pattern or turnover.

5.8 Choice of Form of Business Enterprises

Having discussed the characteristics, merits and limitations of the various forms of organisation (sole proprietorship, joint Hindu family business, partnership, cooperative and company organisation) we may consider how to select the most suitable form of organisation for a business venture. Choice of a suitable form of organisation is important because the success and growth of a business depends a great deal on it. The form of organisation determines the availability of finance, risk associated with business, division of profit, owners' control, stability and durability of business, and so on. Since business and entrepreneurial objectives vary, no single form of organisation can be considered as the best for all kind of business. The selection of a suitable form of organisation is generally, made after careful consideration of the following factors:

(i) Nature of business: This kind of business activity has a bearing on the form of ownership. If the work requires personal attention such as hair dressing saloons and customised tailoring units it is generally, set up as a sole proprietorship. Units engaged in large scale manufacturing, chain stores, and large departmental stores requiring heavy investment are more likely to be companies. Organisations engaged in pursuing welfare activities for their members are usually, cooperative societies. Firms rendering professional services, such as chartered accountants, lawyers and architects are either sole proprietorships or partnerships. The most large retailers and wholesalers are partnerships, and small retailers normally sole traders. Likewise, family businesses are likely to be HUFs or private companies.

(ii) Financial requirements for starting and expanding business: Enterprises requiring heavy investment, such as the airlines, chemical plants auto manufacturing units need to be organised and are formed as companies. Similarly, the future requirements of growth and expansion is another relevant factor. The company form of organisation offers the maximum scope for further growth and expansion. On the other hand, where the funds required are small and there are no immediate plans of expansion, a proprietorship, or partnership is a better choice.

(iii) Degree of control desired: A person, who desires full and exclusive control over business prefers proprietorship rather than partnership or company because control has to be shared in these cases.

(iv) Degree of risk involved: The degree of risk and the willingness of owners to bear it, is an important consideration in the choice of form of organisation where the project is risky or where it requires large financial resources, due to unlimited personal liability the promoter may not like to organise as a proprietor or a partnership. He may opt for a company form as there is diffusion of risk in a public company.

(v) Freedom from government regulations: Sole proprietorships and partnerships continue to be popular forms of organisation, despite the unlimited liability factor associated with them. One major reason for their popularity is the relative freedom they enjoy from government control. Companies and cooperative on the other hand are subject to many government regulations, and this involves both time and money. This lack of freedom from government regulation is one of the deciding factors in the formation of a company, for many businesspersons.

(vi) Duration of business venture: Temporary, short term and *ad hoc* ventures are generally, organised as proprietorships or partnerships because they are easy to form and dissolve. But, where the business interest is permanent or long term, the company with its feature of perpetual succession is the most appropriate.

Ultimately, it needs to be emphasised that the above factors are inter-related and influence each other. For instance, the financial requirements of a business depend upon the nature of business as well as the scale of operations. The establishment of an industrial enterprise (production of toys, for example) on a large scale would need greater outlay of capital, than a small enterprise for the same purpose. Similarly, the degree of risk and liability will depend both on the amount invested and the nature of demand for the products of the enterprise. Thus, for a small enterprise (say, a workshop or a grocery shop) the risk will be limited and so will be the owner's liability, even if personal assets may be used to discharge business debts. Control and sharing of profit are interconnected and both are related to the risk and liability. If, the risk and liability are not heavy, the entrepreneur would not like to give up control and share profits with others.

A few examples to illustrate the suitability of different form of business enterprise are given below:

(i) Proprietorships: Local grocery stores, stationery shops, bakeries, customised tailoring units, hair cutting saloons, small factories, hawkers, small retail outlets, dry cleaners and other enterprises requiring limited capital, low risks and the use of personal knowledge.

(ii) Partnerships: Professional services, such as chartered accountancy firms, architect firms, law firms etc., wholesalers, restaurants, medium sized trading concerns, and enterprises requiring the involvement of additional persons.

(iii) Private companies: Medium sized manufacturing units, hotels, relatively large trading concerns, and any business ventures requiring greater capital outlay and managerial requirements than a partnership.

(iv) Public companies : Airlines, large hotels, large trading concerns, departmental stores, chain stores, shopping malls, auto-manufacturers, iron and steel industrial units and any business involving heavy financial outlay, risk, and managerial expertise.

5.9 Factors to be Considered for Starting a Business

Starting a business is a difficult task. It involves financial commitment, risk taking and lots of effort. Many factors are to be considered keeping in view the three broad objectives of a new venture: creation, survival, and profitability. To start a business, some of the key factors are the following:

(i) Market analysis: The entrepreneur should conduct a market analysis to ascertain that the demand for the product or service is substantial and growing. However, at times the demand may not be expressed but latent. In any case, the selected venture should have the potential for large sales volumes and high growth rate.

(ii) Development and production analysis: Another key consideration relates to the research, development and production of the goods or service. A detailed outline of each of the stages involved in the accomplishment of the core function is constructed. Details of the time and money allocated to each stage are worked out. Besides, a detailed resource requirement is done to outline the physical, financial, human technological and organisational resources that will be required.

(iii) Financial analysis: A detailed list of all physical assets needed, and a statement of organi-sational costs including legal construction engineering, etc. should be prepared. The person intending to start a business must have a fairly accurate idea about the amount of funds required for the project. Either he should possess the money or be in a position to mobilise it. Adequate finance at reasonable cost and time is an important ingredient for business success.

(iv) Location of business: This is an important decision because it affects several components of cost, especially, for manufacturing units. Therefore, computer and other professionals in urban and metros have recently adopted the home-office norm, referred to as SOHO (small office home office), as a cost saving measure. But, where plant and machinery has to be installed, and transportation charges to be incurred on both raw materials and finished goods, the decision have to be taken with great care so as to minimise costs.

Units located in urban commercial centres and industrial areas involve heavy initial expenditure. But, they have the advantage of developed infrastructure, such as telecommunications, transport and electricity. On the other hand, industries set up in backward or remote areas implies much cheaper set up costs. But, transportation costs on finished goods and raw materials which have to be incurred prove to be very disadvantageous.

(v) Personal characteristics: A crucial factor in this decision is the mind set of the person intending to start business. Only one with entrepreneurial instincts and risk taking ability should enter into business. The extra conservative, extremely careful and risk averse individuals should not undertake business activities.

(vi) Government policy: A careful study should be done to analyse whether any government actions in the past have contributed to the development of the particular product/sector selected and also the current government stand and position on it. A liberal import regime, strict health and safety standards and a heavy tax structure will be detrimental to the business prospects of the product under these conditions. The demand as recorded in the past will no longer represent potential demand. It is a warning bell for the prospective investor. On the other hand, the government may be promoting a particular sector/product with tax concessions and soft loans. Thus, this exogenous factor of government policy is an important consideration.

5.10 Scope for Setting Up Small Business

Despite the growth of large scale industry, small business has survived and progressed because it has its own specialised areas of operating. The following factors make way for the scope of small business enterprises:

(i) Limited resources: Individuals with entrepreneurial spirit but with limited economic means and resources always have before them the option of starting a small business. Furthermore, a small business can be established without much legal procedures.

(ii) Flexibility: Small firms are able to react more quickly to changes in the environment. They are usually, owner-operated, and this allows them to try new products, new methods, and new ideas without requiring lengthy and elaborate approval procedures.

(iii) Personal touch: Small enterprises are more likely to succeed in areas requiring *personal touch* in handling customers. Fine restaurants, high-style boutiques, hair cutting saloons and custom jewellery stores are examples, where the personal touch is needed and most of these continue to be small firms.

(iv) Limited demand: When the market for any goods and services is limited, a small business may be able to survive on the demand generated by the limited market. Big companies may not find it worthwhile to invest in such projects because the demand is not sufficient to make mass produc-tion worthwhile. Some markets would not be served were it not for small business. Examples are antique dealers, and art galleries for budding artists with limited means.

(v) Supplying the needs of large corporations: Small businesses play an important role in the operations of large corporations, acting as distributors, servicing agents, and vendors. In India, a lot of successful companies are outsourcing their requirement from small business vendors, by exercising strict quality control standards over them.

(vi) Individual temperament: Small business is a way of life for people who can't stand the boss. Individuals sometimes temperamentally are too independent, and would be unhappy to take orders from others. For such persons, the option of starting their own business always exists.

(vii) Inherent disadvantages of large business: Furthermore, the scope of small business emanates from the inherent weaknesses of large corporations such as:

(a) The potential for too much concentration of economic power;
(b) The potential for reduced management efficiency;
(c) The lack of personal touch between managers and the subordinates leading to sour industrial relations i.e., labour management disputes.

Small business in India includes the following:

(i) Small Scale Industries (SSIs) i.e., Units where investment in plant and machinery is upto Rs 1 crore;
(ii) Tiny units i.e., Units where investment in plant and machinery is Rs 25 lakh. (industry includes industry and industry related services);
(iii) Small business enterprises are prevalent in all parts of the world. But in a developing country such as ours they occupy a place of special significance. They have an important role in India's industrial development;
(iv) They are labour intensive and have great employment generation potential;
(v) They promote regional development by using local resources and personnel;
(vi) They contribute to an equitable distribution of national income.

For these reasons, steps for the development of small scale and cottage industries have been initiated by the government right since independence. Successive policy guidelines (Industrial Policy Resolutions) as well as 5 Year Plan documents have

Contribution of Small Scale Industries (SSIs) in India

Forty per cent of country's industrial output;

Thirty per cent of country's exports;

Eighty per cent of employment in the industrial sector.

Source : Business World

attempted to promote and assist such industries. The important measures adopted are the following:

(i) Reservation of 800 items for exclusive production by the SSIs.

(ii) Liberalised credit norms and procedures for borrowings from commercial banks.

(iii) Price and purchase preference to products manufactured by SSIs in government purchase programme.

(iv) Excise duty exemption upto Rs 1 crore of production case of SSI units.

(v) Permitted equity participation in the SSI by other industrial unit upto 24 per cent of total share-holding. Large industries can now lend support to smaller business.

(vi) Permitted a new legal form of business organisation namely limited partnership. In a limited partnership, the liability of at least 1 partner is unlimited where as other partners have limited liability. Thus, small business can now attract capital from friends and relatives, who will now be sure that their liability in the venture is limited

(vii) The National Equity Fund (NEF) scheme provides equity type support to entrepreneurs for setting up new projects or expansion in tiny/small sector. This is in the form of a soft loan, no interest charged except for service charge of 1 per cent per annum.

(viii) SIDBI has formulated a Credit Guarantee Fund Trust (CGFT) for small industries for guaranteeing the loans and advances upto Rs 10 lakh, without collaterals or third party guarantees.

(ix) SIDBI has formulated Micro Credit Schemes to provide loan assistance to Self Help Groups such as :

(a) Societies registered under Societies Act;

(b) Trusts registered under Public Trust Act;

(c) Section 25 Companies;

(d) Institutions and Finance Companies focusing on banking with the poor;

(e) Cooperatives and Specialised Cooperatives such as Mutually Aided Cooperatives.

What SSIs Need to Comply With

Statue	*Nature of Compliance*
The Employees' State Insurance Act	Remittance contribution
The Employees' State Insurance Act	Declaration form
The Employees' Provident Fund	Remittance of PF contributions
The Employees' Provident Fund and MP Acts	Return of employees
Member's Ledger	To be posted and kept (to be sent to RPFC by the year end)
The Apprentices Act	Bill for reimbursement
The Factories Act	Notice of accident
The Factories Act	Notice of dangerous occurrence
The Workmen's Compensation Act	Report of fatal accidents
N.A.	Annual return

Source : Business World

The Woes of the Small Entrepreneur

The small sector is wilting under the pressure of over-regulation. A number of factors, including over-regulation, archaic laws and the government's reservation policy, have adversely impacted the small scale industry (SSI). Small sector units are on the verge of closure due to the fast-changing business environment. A recent study by the Confederation of Indian Industry (CII) pinpoints the problems and sets an agenda to ensure the survival of the SSIs.

While the government is busy dismantling the licensing and regulatory raj for big business, the tiny sector is still plagued by over-regulation and rampant corruption. For example, a small entrepreneur needs as many as 24 clearances (from registration to sanitation) from various departments before he can set up a new unit. There are around 15 different legislations (The Factories Act, Payment of Wages Act, The Employees State Insurance Act) that govern his day-to-day working. Worse, during a year, his factory may be visited by nearly 40 inspectors from various departments under different ministries (Planning and Statistics, Finance, Health and Family Welfare). The CII study recommends that instead of a multiplicity of laws, a single law (Single Small Business Establishment Act) should govern small units.

The Need to be More Competitive

SSIs should focus on comparative advantage and sub-contracting. The World Trade Organisation (WTO) rules have far-reaching implications for the Indian SSIs. This is particular so for units in areas like toys, where Chinese goods are dominating the market. Three key areas of impact include the removal of quantitative restrictions of imports (by 2003, most physical control will go), the consistent fall in import duties (by 2005, the duty ceiling on finished goods will be 40 per cent and 25 per cent for intermediates) and the provision of actionable subsidies pertaining to import (importing nations can impose additional duties on Indian exports). Therefore, the SSI needs to learn to survive without subsidies and face competition from low-cost producers from countries like China without the protection of high tariff barriers. The CII study recommends the SSIs reposition themselves in strategic areas where India has comparative advantages, develop India as a subcontracting base and improve quality through technological upgradation.

SUMMARY

Business undertaking: This is an organisation through which business activities are carried out. For the private sector in India the forms of business organisations/enterprises are: sole proprietorship, joint Hindu family business; partnership; cooperative society; and company.

Sole proprietorship: This is a form of business that is owned, managed and controlled by an individual. The sole proprietor alone is entitled to the profits and has to bear the losses. Her/his liability is unlimited. This form of organisation has the advantages of: ease of formation and closure, simplicity of operation and flexibility of management, undivided claim on profits and the benefits of small scale operations. However, it suffers from the limitations of management skills, capital, unlimited liability and lack of continuity.

Joint Hindu family business: This refers to a business organisation owned by the members of a joint Hindu family. It is governed by the Hindu law. Only male members, restricted to three successive generation can become its members. Thus, membership is not created by an agreement but is determined by birth. The oldest member is called *Karta* and is responsible for managing the business. Except for him, the liability of other members is limited.

Partnership: This form of organisation is an association of persons who pool their financial resources and managerial abilities to share the profits of a business in an agreed ratio. The partnership organisation is formed on the basis of agreement between a minimum of 2 persons to carry on a business. A maximum of 20 persons can be members in partnership. In a partnership organisation, each partner is a principal and that agent of other partners and can bind the firm by his acts. The liability of partners is unlimited. Registration of a partnership firm is not compulsory. But when so desired it may be registered with the Registrar of Firms under the Indian Partnership Act.

Types of partners: Various types of partners are found in partnership firms: active and sleeping partners (full-fledged partners), nominal partners and partners by holding out. A minor can also be admitted into the benefits of partnership. These partners may be found in all the three types of partnership organisation namely, partnership at will, particular partnership and partnership for a fixed duration.

A partnership organisation offers several advantages, like ease of formation, pooling of financial and managerial resources, balanced business decisions and sharing of risks. However, it also suffers from limitations, like uncertainty of existence, risks of implied authority, risk of disharmony, difficulty in withdrawal from the firm, lack of institutional confidence and difficulties of expansion and modernisation.

Cooperative: This form of organisation is established by a group of persons who voluntarily come together for mutual benefit. The aims of a cooperative society are accomplished through self-help and collective effort. The principle of one-man-one-vote governs the functioning of a cooperative. The capital of a cooperative society is raised by issue of shares to the members, and as loans from the State and Central Cooperative Banks. Out of the profits, the members are paid dividend and bonus according to the business transacted by them with the cooperative society. Unlike, sole proprietorship and partnership, a cooperative organisation has a separate legal entity. It can be registered with the Registrar of Cooperative Societies.

Cooperative societies: The main types are — consumers cooperatives; producers cooperatives; cooperative credit societies; marketing cooperatives; cooperative farming societies; and cooperative housing societies.

A Cooperative organisation has advantages, like ease of form action, open membership, democratic management, limited liability, government patronage, and other non-economic benefits. A cooperative organisation has also certain limitations, like limited capital, inefficient management, absence of motivation, differences among members, rigid government rules and regulations.

Company: This form of organisation may be defined as an artificial person created by law, having a separate legal entity, perpetual succession, a common seal and the capital fund consisting of transferable shares, with limited liability. These features of a company organisation permit it to conduct business on a large scale and also overcome the limitations of capital and management of sole proprietorship, partnership and cooperatives. In spite of these features and advantages, a company organisation has several limitations such as lengthy and expensive legal procedure, excessive government regulations, lack of incentive of managers, delay in decision-making and action, conflict of interest, oligarchic management, speculation, growth of monopolistic tendencies and influencing government decision for narrow interests.

Private company: This company is one which restricts its membership to a maximum of 50; is prohibited from inviting the public to subscribe to its capital; and restricts transferability of its shares. The private company enables a small group of persons to control the management of the company without the risk of displacement by a large shareholding group.

Public company: This company is one which does not have any of the restrictions that apply to a private company. It is an ideal form of organisation for starting business on a large scale.

A private company enjoys several privileges as compared with a public company. It can be formed with only two members, need to have only 2 Directors, and is not required to maintain an index of members Further, it is not required to get the approval of government for granting loans to Directors. It is also exempt from certain legal formalities.

The main purpose of discussing the features, merits and limitations of the various forms of private enterprises is to select a form of organisation that can effectively meet the business and entrepreneurial objectives. Since, business and entrepreneurial objectives vary, no single form of organisation can be considered as the best for all kinds of business.

Choice of form of business enterprise: However, the selection of a suitable form of organisation can be made after carefully considering these factors: nature of business, scale of operations, financial requirements, degree of direct control desired by owners, degree of risk and liability, division of profit, flexibility of operations, stability of business, legal procedure. Because these factors are interconnected, their collective effect should govern the final choice.

Factors to be considered for starting a business: To start a business, the key factors are market analysis, development and production analysis, financial analysis, location of business, personal characteristics and government policy.

Small business: The scope for setting up small business despite the growth of large scale industries still exists. There are certain factors which are responsible for the scope of small business enterprises. These are limited resources, flexibility, personal touch, limited demand, supplying the needs of large corporations, individual temperament and inherent disadvantages of large business.

Small business in India include small scale industries and tiny units. Small business enterprises have an important role in India's industrial development. They are labour intensive, promote regional development and contribute to equitable distribution of income. Industrial Policy Resolutions and 5 Year Plan documents have attempted to promote the small scale sector.

EXERCISES

Short Answer Type Questions

1. Discuss whether the sole proprietorship involves a lengthy and expensive procedure for its formation.
2. Explain whether the liability of a sole proprietor is limited to the extent of his share in business.
3. Only the *Karta* has unlimited liability in a HUF. Explain.
4. Define partnership. State its important features.
5. Outline the procedure for registration of partnership.
6. Enumerate the various types of cooperative societies.
7. When is it appropriate to form a sole proprietorship?
8. Give any three limitations of the sole proprietorship as a form of organisation.
9. Can a partnership firm have a minor partner?
10. A cooperative society is not set up for making profits, discuss.
11. Explain how a cooperative is a democratic institution.
12. A company form of organisation is popular because its members have limited liability. Explain why is the company form of organisation is a portion to undertake huge and risked projects?
13. Explain how the company is an artificial person.
14. Discuss whether a company's existence is affected by the death of a member.
15. Explain the concept and external of deemed public companies.
16. Distinguish between partnership and a private company.

Long Answer Questions

1. What do you understand by sole proprietorship? Outline its features. Explain its merits and limitations?
2. "One man control is best in the world if that one man is big enough to manage everything." Explain the statement.
3. Explain the features of a joint Hindu family business.
4. Discuss the merits and limitations of partnership.
5. Describe the various kinds of partners in a partnership firm and discuss their rights and obligations.

6. Define partnership deed. Discuss its main contents.
7. Define cooperative organisation. Explain its main characteristics.
8. Discuss the advantages and limitation of cooperative organisation. Name activities which can be suitably undertaken by cooperative societies.
9. What is a company? What are its characteristics? Explain its advantages and limitations.
10. List the factors that help in choosing a suitable form of organisation.
11. What are the factors to be considered while starting a business? Discuss.
12. Do you think small business units can survive in a competitive market? Explain the scope of small business enterprises in the light of their potential advantages.

Project Work

1. Study the profile of a sole trader commenting on the nature and working of business.
2. Study the working of a partnership firm. Interview each partner and find out how they overcome the difficulties they face in business operations. Some of the questions you can ask are :
   - Do they take decisions jointly?
   - Have they demarcated their areas of operation?
   - How are profits, expenses and drawings accounted for?
   - How do they reconcile their differences?
3. Study the problems faced by any small business unit, regarding finance, marketing, etc.