Paper-4

Foundation Programme

Elements of Business Laws and Management

THE INSTITUTE OF
Company Secretaries of India
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

FOUNDATION COURSE

ELEMENTS OF BUSINESS LAWS AND MANAGEMENT

PART A — ELEMENTS OF BUSINESS LAWS

C O N T E N T S

STUDY I

LAW

Nature, Meaning and Significance of Law
Significance and Relevance to Modern Civilized Society
Sources of Indian Law
A. Principal Sources of Indian Law
B. Secondary Sources of Indian Law
Sources of English Law
Mercantile or Commercial Law
Sources of Mercantile Law
Mercantile Law in India
Sources of Indian Mercantile Law
SELF-TEST QUESTIONS

STUDY II

THE INDIAN CONTRACT ACT, 1872

Meaning and Nature of Contract
Essential Elements of a Valid Contract
(a) Offer or Proposal and Acceptance
(b) Intention to Create Legal Relations
(c) Consideration
Whether Gratuitous Promise can be Enforced
Flaws in Contract
(i) Flaw in capacity - Capacity and Persons
(ii) Mistake
(iii) Misrepresentation
(iv) Wilful Misrepresentation or Fraud
(v) Coercion
(vi) Undue Influence
(vii) Legality of Object
Agreements in Restraint of Trade Void
Wagering Agreements
Void Agreements
Restitution
Contingent Contract

Certain Relations Resembling Those of Contracts (Quasi-Contracts)
Discharge or Termination of Contracts
(a) Performance of Contracts
(b) Discharge by Mutual Agreement or Consent
(c) Discharge by Lapse of Time
(d) Discharge by Operation of the Law
(e) Discharge by Impossibility or Frustration
(f) Discharge by Breach
Remedies for Breach
Contract of Indemnity and Guarantee
Contract of Bailment and Pledge
(a) Bailment
(b) Pledge
Law of Agency
SELF-TEST QUESTIONS
PRACTICAL PROBLEMS

STUDY III

SALE OF GOODS ACT, 1930

Contract of Sale of Goods
Distinction between Sale and Agreement to Sell
Sale and Bailment
Sale and Contract for Work and Labour
Sale and Hire Purchase Agreement
Subject matter of Contract of Sale of Goods
Price
Conditions and Warranties
Doctrine of Caveat Emptor
Passing of Property or Transfer of Ownership
Transfer of Title by Person not the Owner
Performance of the Contract of Sale
Unpaid Seller
Auction Sales
Trading Contracts involving Rail or Sea Transit
SELF-TEST QUESTIONS

STUDY IV

NEGOTIABLE INSTRUMENTS ACT, 1881

Definition of a Negotiable Instrument
Important Characteristics of Negotiable Instruments
Classification of Negotiable Instruments

Kinds of Negotiable Instruments
Banker
Customer
Liability of a Banker
When Banker must Refuse Payment
When Banker may Refuse Payment
Protection to Paying Banker
Payment in Due Course
Collecting Banker
Over-due, Stale or Out-of-date Cheques
Liability of Endorser
Rights of Holder against Banker
Crossing of Cheques
Modes of Crossing
Not Negotiable Crossing
Maturity
Holder
Holder in Due Course
Capacity of Parties
Liability of Parties
Negotiation
Negotiability and Assignability Distinguished
Importance of Delivery
Negotiation by Mere Delivery
Endorsement
Negotiation Back
Negotiation of Lost Instrument or that Obtained by Unlawful Means
Forged Endorsement
Acceptance of a Bill of Exchange
Acceptance for Honour
Presentment for Acceptance
Presentment for Acceptance when Excused
Presentment for Payments
Presentment for Payments when Excused
Dishonour by Non-Acceptance
Dishonour by Non-Payment
Notice of Dishonour
Notice of Dishonour Unnecessary
Noting and Protest
Discharge
Material Alteration
Retirement of a Bill under Rebate

Hundis
Presumptions of Law
Payment of interest in case of dishonour
Penalities in case of dishonour of cheques

SELF-TEST QUESTIONS

STUDY V

INDIAN PARTNERSHIP ACT, 1932

Nature of Partnership
Definitions
Essentials of a Partnership and True Test of Partnership
Formation of Partnership
Partnership Deed
Classification of Partnership
Co-ownership and Partnership
Hindu Joint Family, Firm and Partnership
Company and Partnership
Change in a Firm
Partnership Property
Kinds of Partners
Minor Admitted to the Benefits of Partnership
Rights of Minor
Liabilities of Minor
Relation of Partners to one another
Rights of Partners
Duties of Partners
Relation of Partners to Third Parties
Authority of a Partner
Implied Authority of a Partner
No implied Authority
Extent of Partner Liability
Liability of the Firm for Torts
Liability of an Incoming Partner
Liability of an Outgoing or Retiring Partner
Death or Insolvency
Dissolution
Dissolution of Partnership
Dissolution of the Firm
Dissolution of the Firm through Court
Effect of Dissolution
Right to Return of Premium
Settlement of Accounts on Dissolution

Remaining Deficiencies of Capital
Goodwill
Registration of the Firm
Effects of Non-Registration
Specific Performance of Partnership Agreement
Suit for Libel or Slander

SELF-TEST QUESTIONS

STUDY VI

ELEMENTS OF COMPANY LAW - I

A. COMPANY - MEANING AND CHARACTERISTICS
- Company - Its Meaning
- Company - Its Characteristics
- Company as Distinguished from other Associations of Persons
- Distinction between a Company and a Partnership
- Distinction between a Company and a Hindu Joint Family Business
- Distinction between a Company and a Club
- Distinction between a Company and a Corporation
- Advantages of Incorporation
- Disadvantages of Incorporation
- Lifting or Piercing the Corporate Veil

B. KINDS OF COMPANIES
- Private Company
- Public Company
- Distinction between a Public and a Private Company
- Private Company to become a Public Company in certain cases
- A Company Limited by Shares
- A Company Limited by Guarantee
- An Unlimited Company
- Association not for Profit
- Government Companies
- Foreign Companies
- Holding and Subsidiary Companies

C. PROMOTION AND INCORPORATION OF A COMPANY
- Promotion
- Promoters
- Legal Position of a Promoter
- Registration and Incorporation of Companies
- Commencement of Business
- How Does a Company Function?

SELF-TEST QUESTIONS

STUDY VII

ELEMENTS OF COMPANY LAW - II

A. COMPANY MANAGEMENT BOARD OF DIRECTORS, MANAGING DIRECTOR, WHOLETIME DIRECTOR, MANAGER, ETC.
Directors
Meaning of a Director
Who Can be a Director?
Who Cannot be a Director?
Only Individuals to be Directors
Number of Directors
Appointment of Directors
First Directors
Appointment by Shareholders in General Meeting
Appointment by the Board
Appointment by the Central Government
Removal of Directors
General Powers vested in the Board
Power to be exercised only at Board Meetings
Managerial Personnel
Definition of Managing Director
Disqualifications of Managing Director
Manager
Disqualifications of Manager
Tenure of office of a Managing Director or Manager
B. SHAREHOLDERS
C. MEETINGS
Meaning of a Meeting
Kinds of Company Meetings
Statutory Meeting
Statutory Report
Notice of Statutory Meeting
Contents of the Statutory Report
Certification of the Statutory Report
Registration of the Statutory Report
Scope of the Statutory Meeting
Adjournment of the Statutory Meeting
Annual General Meeting
Extraordinary General Meetings
Class Meetings

Meetings of Debentureholders
Meetings of Creditors'
Meetings of Board of Directors

D. SECRETARY
Definition of Secretary
Qualifications of a Company Secretary
Appointment of a Secretary
Powers of Secretary
Duties of a Secretary
(a) Contractual Duties
(b) Statutory Duties
Role of a Secretary in a Company

SELF-TEST QUESTIONS

PART B — ELEMENTS OF MANAGEMENT

STUDY VIII

NATURE OF MANAGEMENT AND ITS PROCESS

The Concept
Schools of Management
The Management Functions
Goals of a Manager
Coordination the Essence of Management
Development of Management Theory
Administration and Management
Management - Science or Art
Management as Profession
Competent Managerial Personnel

SELF-TEST QUESTIONS

STUDY IX

PLANNING – POLICIES AND DECISION-MAKING

Nature of Planning
Utility of Planning
Types of Plans
Steps involved in Planning
Planning Premises
The Planning Period
Forecasting
Decision-Making

Hierarchy of Decisions
Decision-Making by Groups
Evaluating the Decision's Importance
Limitations of Planning

SELF-TEST QUESTIONS

STUDY X

ORGANISATION (I)

Organisation as a Process and Structure
Purpose and Cause of Organising
Dynamic Organisation Structure
Organisation as Part of the Total Management Task
Traditional Principles of Organisation Structure
Developing an Organisation Structure
Theories of Organisation
The Classical Approach to Organisation
The Neo-Classical Approach to Organisation
The Decision-Making Approach
The Systems Approach
Contingency Organisation Theory
Contingency Approach to Management
Span of Management
Wide versus Narrow Spans
Operational School Position
Graicunas' Theory of Superior Subordinate Relationships

AUTHORITY AND RESPONSIBILITY
Nature of Authority
Responsibility
    Accountability
Sources of Authority
Limits of Authority
Authority Power Continuum
Delegation of Authority
The Process of Delegation
Barriers to Delegation
Principles of Delegation

CENTRALISATION AND DECENTRALISATION
Meaning
Advantages of Decentralisation
Advantages of Centralisation
Factors Determining the Degree of Decentralisation
Delegation and Decentralisation

SELF-TEST QUESTIONS

STUDY XI

ORGANISATION (II)

DEPARTMENTATION, FORMAL ORGANISATION STRUCTURE, INFORMAL ORGANISATION

DEPARTMENTATION
Meaning
Patterns used in Departmentation
Departmentation by Functions
Advantages of Departmentation by Functions
Disadvantages of Functional Departmentation
Departmentation by Product or Services
Grouping by Locations or Territories
Departmentation by Time
Grouping by Process and Equipment
Grouping by Customers
Principles of Departmentation

FORMAL ORGANISATION STRUCTURE

1. Line Organisation
2. Functional Organisation
3. Line and Staff Organisation
4. Project Management Organisation
5. Matrix Organisation

INFORMAL ORGANISATION
Meaning
Functions of Informal Groups
Problems Associated with Informal Organisation
Benefits of Informal Organisation
Control of Informal Organisation
Growth in Organisation

SELF-TEST QUESTIONS

STUDY XII

STAFFING

Meaning, Nature and Functions of Personnel Management
Meaning and Nature of the Staffing Function
Importance
The Logic of Staffing

The Staffing Process
Manpower Planning
Recruitment
Selection and Placement
Selection and Recruitment
Training and Development
Job Changes
Promotion Policy
Transfer Policy
Performance Appraisal
Methods of Appraisal

SELF-TEST QUESTIONS

STUDY XIII

COMMITTEE IN MANAGEMENT AND CO-ORDINATION

COMMITTEE IN MANAGEMENT
The Concept of Committees
The Plural Executive
Advantages of Committees
Disadvantages of Committees
Misuse of Committees
Making Better use of Committees
CO-ORDINATION
Nature and Techniques of Co-ordination
External Co-ordination
Principles of Co-ordination
Considerations in Co-ordination

SELF-TEST QUESTIONS

STUDY XIV

MANAGEMENT OF CHANGE AND ORGANISATION DEVELOPMENT

MANAGEMENT OF CHANGE
Introduction
Meaning of Change and its Causes
Resistance to Change
Why Change is Resisted?
Overcoming Resistance to Change
Concept of Flexibility
Stimulating Participation
Change through the management Hierarchy
Lewin’s Three-step Model
Action Research

ORGANISATION DEVELOPMENT
Introduction
Organisation Development Defined
Planned Organisational Change
Top Management Commitment to Organisation Development
Increase in Organisation Effectiveness
Planned Intervention
Social Philosophy as a Norm of Change
Characteristics of Organisation Development
Goals of Planned Interventions
Stages in Organisation Development Effort
Organisation Developments Management Development
and Operations Research
SELF-TEST QUESTIONS

STUDY XV

DIRECTING AND COMMUNICATION

DIRECTING
Introduction
Principles of Direction
Means of Direction
Approaches to Direction
COMMUNICATION
Nature of Communication
Importance of Effective Communication
Principles of Communication
Channels of Communication
Crosswise Communication
Communication Media
Communication Barriers
Overcoming Barriers to Communication
The Union Role in Communication
SELF-TEST QUESTIONS

STUDY XVI

MOTIVATION MORALE AND LEADERSHIP

MOTIVATION
Meaning and Nature
Motivational Terminology
The Need-want-satisfaction Chain
Usefulness of Motivation in Management
Steps in Motivation

Motivation and Behaviour
Transactional Analysis
Selected Theories of Motivation
(a) Monistic or Economic Theory of Motivation
(b) The Hierarchy of Needs Theory
(c) The Theory of Douglas McGregor
(d) Herzberg's Motivation - Hygiene Theory
(e) Expectancy Theories of Motivation
(f) McClelland's Needs Theory of Motivation
(g) Equity Theory of Motivation
(h) Contingency Model of Motivation
(i) Sound Motivation System

MORALE
Nature of Morale
Morale and Productivity
Factors Determining Morale
Knowing the Prevailing Morale

LEADERSHIP
Meaning and Nature
Leadership and Management

Formal and Informal Leaders

Approaches for Examining Leadership Behaviour
Cultivated Leadership Attitudes
Functions of Leadership

SELF-TEST QUESTIONS

STUDY XVII

CONTROL AND ITS PROCESS

Definition and Nature of Control
Essential Elements of Controlling
Requirements of Effective Control System
Budgetary Control
(A) Elements of Budgetary Control
(B) Purpose of Budgeting
(C) Types of Budget
(D) Benefits of Budgeting
(E) Dangers in Budgeting
(F) Essentials for Success
(G) Reporting
(H) Zero Base Budgeting
Traditional Non-Budgetary Control Devices

Control of Overall Performance
Network Analysis
Management Audit
Total Quality Management
SELF-TEST QUESTIONS

STUDY XVIII

SOCIAL RESPONSIBILITY OF BUSINESS

Introduction
Concept of Business
Business and its Environment
Objectives of Business
Concept of Social Responsibility
What Social Responsibility of Business Means
Why Should Business be Socially Responsible
Social Responsibilities of a Business
Conclusion
SELF-TEST QUESTIONS

APPENDIX- GLOSSARY OF LEGAL TERMS/MAXIMS

TEST PAPERS/2007
- Test Paper 1/2007
- Test Paper 2/2007

QUESTION PAPER OF TWO PREVIOUS SESSIONS

PART A — ELEMENTS OF BUSINESS LAWS

STUDY I

LAW

1. Nature, Meaning and Significance of Law

The nature and meaning of law has been described by various jurists. However, there is no unanimity of opinion regarding the true nature and meaning of law. The reason for lack of unanimity on the subject is that the subject has been viewed and dealt with by different jurists so as to formulate a general theory of legal order at different times and from different points of view, that is to say, from the point of view of nature, source, function and purpose of law, to meet the needs of some given period of legal development. Therefore, it is not practicable to give a precise and definite meaning to law which may hold good for all times to come. However, it is desirable to refer to some of the definitions given by different jurists so as to clarify and amplify the term "law". The various definitions of law propounded by legal theorists serve to emphasise the different facets of law and build up a complete and rounded picture of the concept of law.

Hereinafter we shall refer to some representative definitions and discuss them. For the purpose of clarity and better understanding of the nature and meaning of law, we may classify the various definitions into five broad classes:

(a) Idealistic,
(b) Positivistic,
(c) Historical,
(d) Sociological, and
(e) Realistic.

(a) *Idealistic Definition of Law:* Under this class fall most of the ancient definitions given by Roman and other ancient Jurists.

Ulpine defined Law as "the art or science of what is equitable and good."

Cicero said that Law is "the highest reason implanted in nature."

Justinian's Digest defines Law as "the standard of what is just and unjust."

In all these definitions, propounded by Romans, "justice" is the main and guiding element of law.

Ancient Hindu view was that 'law' is the command of God and not of any political sovereign. Everybody including the ruler, is bound to obey it. Thus, 'law' is a part of "Dharma". The idea of "justice" is always present in Hindu concept of law.

Salmond, the prominent modern idealistic thinker, defines law as "the body of principles recognised and applied by the State in the administration of justice."

In other words, the law consists of rules recognised and acted on by the courts of Justice. It may be noted that there are two main factors of the definition. First, that to understand law, one should know its purpose: Second, in order to ascertain the true nature of law, one should go to the courts and not to the legislature.

Vinogradoff described Law as "a set of rules imposed and enforced by society

with regard to the attribution and exercise of power over persons and things."

(b) *Positivistic Definition of Law:* According to Austin, "Law is the aggregate of rules set by man as politically superior, or sovereign, to men as political subject." In other words, law is the "command of the sovereign". It obliges a certain course of conduct or imposes a duty and is backed by a sanction. Thus, the command, duty and sanction are the three elements of law.

Kelsen gave a 'pure theory of law'. According to him, law is a 'normative science'. The legal norms are 'Ought' norms as distinct from 'Is' norms of physical and natural sciences. Law does not attempt to describe what actually occurs but only prescribes certain rules. The science of law to Kelson is the knowledge of hierarchy of normative relations. All norms derive their power from the ultimate norm called *Grund norm.*

(c) *Historical Definition of Law*: Savigny's theory of law can be summarised as follows:

(i) That law is a matter of unconscious and organic growth. Therefore, law is found and not made.

(ii) Law is not universal in its nature. Like language, it varies with people and age.

(iii) Custom not only precedes legislation but it is superior to it. Law should always conform to the popular consciousness.

(iv) Legislation is the last stage of law making, and, therefore, the lawyer or the jurist is more important than the legislator.

According to Sir Henry Maine, "The word 'law' has come down to us in close association with two notions, the notion of order and the notion of force".

(d) Sociological Definition of Law: Duguit defines law as "essentially and exclusively as social fact."

Ihering defines law as "the form of the guarantee of the conditions of life of society, assured by State's power of constraint". There are three essentials of this definition. First, in this definition law is treated as only one means of social control. Second, law is to serve social purpose. Third, it is coercive in character.

Roscoe Pound analysed the term "law" in the 20th century background as predominantly an instrument of social engineering in which conflicting pulls of political philosophy, economic interests and ethical values constantly struggled for recognition against background of history, tradition and legal technique. Pound thinks of law as a social institution to satisfy social wants – the claims and demands and expectations involved in the existence of civilised society by giving effect to as must as may be satisfied or such claims given effect by ordering of human conduct through politically organised society.

(*e) Realist Definition of Law:* Realists define law in terms of judicial process. According to Holmes, "Law is a statement of the circumstances in which public force will be brought to bear upon through courts." According to Cardozo, "A principle or rule of conduct so established as to justify a prediction with reasonable certainty that it will be enforced by the courts if its authority is challenged, is a principle or rule of law."

From the above definitions, it follows that law is nothing but a mechanism of regulating the human conduct in society so that the harmonious co-operation of its

members increases and thereby avoid the ruin by co-ordinating the divergent conflicting interests of individuals and of society which would, in its turn, enhance the potentialities and viability of the society as a whole.

To summarise, following are the main characteristics of law and a definition to become universal one, must incorporate all these elements:

(a) Law pre-supposes a State.

(b) The State makes or authorizes to make, or recognises or sanctions rules which are called law.

(c) For the rules to be effective, there are sanctions behind them.

(d) These rules (called laws) are made to serve some purpose. The purpose may be a social purpose, or it may be simply to serve some personal ends of a despot.

Separate rules and principles are known as “laws”. Such laws may be mandatory, prohibitive or permissive. A *mandatory law* calls for affirmative act, as in the case of law requiring the payment of taxes. A *prohibitive law* requires negative conduct, as in the case of law prohibiting the carrying of concealed weapon or running a lottery. A *permissive law* is one which neither requires nor forbids action, but allows certain conduct on the part of an individual if he desires to act.

Laws are made effective:

(a) by requiring damages to be paid for an injury due to disobedience;

(b) by requiring one, in some instances, to complete an obligation he has failed to perform;

(c) by preventing disobedience; or

(d) by administering some form of punishment.

The law, and the system through which it operates, has developed over many centuries into the present combination of statutes, judicial decisions, custom and convention. By examining the sources from which we derive our law and legal system, we gain some insight into the particular characteristics of our law.

The State, in order to maintain peace and order in society, formulates certain rules of conduct to be followed by the people. These rules of conduct are called “laws”.

Significance and Relevance to Modern Civilized Society

Law is not static. As circumstances and conditions in a society change, laws are also changed to fit the requirements of the society. At any given point of time the prevailing law of a society must be in conformity with the general statements, customs and aspirations of its people.

Modern science and technology have unfolded vast prospects and have aroused new and big ambitions in men. Materialism and individualism are prevailing at all spheres of life. These developments and changes have tended to transform the law patently and latently. Therefore, law has undergone a vast transformation – conceptual and structural. The idea of abstract justice has been replaced by social justice.

The object of law is order which in turn provides hope of security for the future. Law is expected to provide socio-economic justice and remove the existing imbalances in the socio-economic structure and to play special role in the task of achieving the various socio-economic goals enshrined in our Constitution. It has to serve as a vehicle of social change and as a harbinger of social justice.

Sources of Indian Law

The expression "sources of law" has been used to convey different meanings. There are as many interpretations of the expression "sources of law" as there are schools and theories about the concept of law. The general meaning of the word "source" is origin. There is a difference of opinion among the jurists about the origin of law. Austin contends that law originates from the sovereign. Savigny traces the origin in Volkgeist (general consciousness of the people). The sociologists find law in numerous heterogeneous factors. For theologians, law originates from God. Vedas and the Quran which are the primary sources of Hindu and Mohammedan Law respectively, are considered to have been revealed by God. Precisely, whatever source of origin may be attributed to law, it has emanated from almost similar sources in most of the societies.

The modern Indian law as administered in courts is derived from various sources and these sources fall under the following two heads:

(A) Principal sources of Indian Law.

(B) Secondary sources of Indian Law.

(A) Principal Sources of Indian Law

The principal sources of Indian law are:

(i) Customs or Customary Law.

(ii) Judicial Decisions or Precedents.

(iii) Statutes or Legislation.

(iv) Personal Law e.g., Hindu and Mohammedan Law, etc

(i) Customs or Customary Law

Custom is the most ancient of all the sources of law and has held the most important place in the past, though its importance is now diminishing with the growth of legislation and precedent.

A study of the ancient law shows that in primitive society, the lives of the people were regulated by customs which developed spontaneously according to circumstances. It was felt that a particular way of doing things was more convenient than others. When the same thing was done again and again in a particular way, it assumed the form of custom.

Customs have played an important role in moulding the ancient Hindu Law. Most of the law given in Smritis and the Commentaries had its origin in customs. The Smritis have strongly recommended that the customs should be followed and recognised. Customs worked as a re-orienting force in Hindu Law.

Custom as a source of law has a very inferior place in the Mohammedan Law.

However, customs which were not expressly disapproved by the Prophet were good laws. It was on the basis of such customs that Sunnis interpreted many provisions of the law, especially the law of divorce and inheritance. In India, many sects of Mohammedans are governed by local customary law.

Classification of Customs

The customs may be divided into two classes:

(1) Customs without sanction.

(2) Customs having sanction.

1. Customs without sanction are those customs which are non-obligatory and are observed due to the pressure of public opinion. These are called as "positive morality".

2. Customs having sanction are those customs which are enforced by the State. It is with these customs that we are concerned here. These may be divided into two classes: (1) Legal, and (2) Conventional.

1. *Legal Customs:* These customs operate as a binding rule of law. They have been recognised and enforced by the courts and therefore, they have become a part of the law of land. Legal customs are again of two kinds: (a) Local Customs (b) General Customs.

(a) *Local Customs:* Local custom is the custom which prevails in some definite locality and constitutes a source of law for that place only. But there are certain sects or communities which take their customs with them wherever they go. They are also local customs. Thus, local customs may be divided into two classes:

(i) Geographical Local Customs, and

(ii) Personal Local Customs.

These customs are law only for a particular locality, sect or community.

(b) *General Customs:* A general custom is that which prevails throughout the country and constitutes one of the sources of law of the land. The Common Law in England is equated with the general customs of the realm.

2. Conventional Customs: These are also known as "usages". These customs are binding due to an agreement between the parties, and not due to any legal authority independently possessed by them. Before a Court treats the conventional custom as incorporated in a contract, following conditions must be satisfied:

1. It must be shown that the convention is clearly established and it is fully known to the contracting parties. There is no fixed period for which a convention must have been observed before it is recognised as binding.
2. Convention cannot alter the general law of the land.
3. It must be reasonable.

Like legal customs, conventional customs may also be classified as general or local. Local conventional customs are limited either to a particular place or market or to a particular trade or transaction.

Requisites of a Valid Custom

A custom will be valid at law and will have a binding force only if it fulfills the following essential conditions, namely:

(a) *Immemorial (Antiquity):* A custom to be valid must be proved to be immemorial; it must be ancient. According to Blackstone "A custom, in order that it may be legal and binding must have been used so long that the memory of man runs not to the contrary, so that, if any one can show the beginning of it, it is no good custom". English Law places a limit to legal memory to reach back to the year of accession of Richard I in 1189 as enough to constitute the antiquity of a custom. In India, the English Law regarding legal memory is not applied. All that is required to be proved is that the alleged custom is ancient.

(b) *Certainty:* The custom must be certain and definite, and must not be vague and ambiguous.

(c) *Reasonableness:* A custom must be reasonable. It must be useful and convenient to the society. A custom is unreasonable if it is opposed to the principles of justice, equity and good conscience.

(d) *Compulsory observance:* A custom to be valid must have been continuously observed without any interruption from times immemorial and it must have been regarded by those affected by it as an obligatory or binding rule of conduct.

(e) *Conformity with law and public morality:* A custom must not be opposed to morality or public policy nor must it conflict with statute law. If a custom is expressly forbidden by legislation and abrogated by a statute, it is inapplicable.

(f) *Unanimity of opinion:* The custom must be general or universal. If practice is left to individual choice, it cannot be termed as custom.

(g) *Peaceable enjoyment:* The custom must have been enjoyed peaceably without any dispute in a law court or otherwise.

(h) *Consistency:* There must be consistency among the customs. Custom must not come into conflict with the other established customs.

(ii) Judicial Precedents

In general use, the term "precedent" means some set pattern guiding the future conduct. In the judicial field, it means the guidance or authority of past decisions of the courts for future cases. Only such decisions which lay down some new rule or principle are called judicial precedents.

Judicial precedents are an important source of law. They have enjoyed high authority at all times and in all countries. This is particularly so in the case of England and other countries which have been influenced by English jurisprudence. The principles of law expressed for the first time in court decisions become precedents to be followed as law in deciding problems and cases identical with them in future. The rule that a court decision becomes a precedent to be followed in similar cases is known as doctrine of stare decisis.

The reason why a precedent is recognised is that a judicial decision is presumed to be correct. The practice of following precedents creates confidence in the minds of

the litigants. Law becomes certain and known and that in itself is a great advantage. Administration of justice becomes equitable and fair.

General Principles of Doctrine of Precedents

The first rule is that each court lower in the hierarchy is absolutely bound by the decisions of the courts above it.

The second rule is that in general higher courts are bound by their own decisions. This is a special feature of the English law.

High Courts

(1) The decisions of *High Court* are binding on all the subordinate courts and tribunals within its jurisdiction. The decisions of one High Court have only a persuasive value in a court which is within the jurisdiction of another High Court. But if such decision is in conflict with any decision of the High Court within whose jurisdiction that court is situated, it has no value and the decision of that High Court is binding on the court.

In case of any conflict between the two decisions of co-equal Benches, generally the later decision is to be followed.

(2) In a High Court, a single judge constitutes the smallest *Bench*. A Bench of two judges is known as *Division Bench*. Three or more judges constitute a *Full Bench.* A decision of such a Bench is binding on a *Smaller Bench.*

One Bench of the same High Court cannot take a view contrary to the decision already given by another co-ordinate Bench of that High Court. Though decision of a *Division Bench* is wrong, it is binding on a single judge of the same High Court.

Thus, a decision by a Bench of the High Court should be followed by other Benches unless they have reason to differ from it, in which case the proper course is to refer the question for decision by a *Full Bench.*

(3) The High Courts are the Courts of co-ordinate jurisdiction. Therefore, the decision of one High Court is not binding on the other High Courts and have persuasive value only.

Pre-constitution (1950) Privy Council decisions are binding on the High Courts unless overruled by the Supreme Court.

(4) The Supreme Court is the highest Court and its decisions are binding on all courts and other judicial tribunals of the country. Article 141 of the Constitution makes it clear that the law declared by the Supreme Court shall be binding on all courts within the territory of India. The words “law declared” includes an *obiter dictum* provided it is upon a point raised and argued (*Bimladevi* v. *Chaturvedi,* AIR 1953 All. 613). However, it does not mean that every statement in a judgement of the Supreme Court has the binding effect. Only the statement of ratio of the judgement is having the binding force.

Supreme Court

The expression ‘all courts’ used in Article 141 refers only to courts other than the Supreme Court. Thus, the Supreme Court is not bound by its own decisions. However, in practice, the Supreme Court has observed that the earlier decisions of

the Court cannot be departed from unless there are extraordinary or special reasons to do so (AIR 1976 SC 410). If the earlier decision is found erroneous and is thus detrimental to the general welfare of the public, the Supreme Court will not hesitate in departing from it.

English decisions have only persuasive value in India. The Supreme Court is not bound by the decisions of Privy Council or Federal Court. Thus, the doctrine of precedent as it operates in India lays down the principle that decisions of higher courts must be followed by the courts subordinate to them. However, higher courts are not bound by their own decisions (as is the case in England).

Kinds of Precedents

Precedents may be classified as: (a) declaratory and original, (b) persuasive, (c) absolutely authoritative, and (d) conditionally authoritative.

(a) *Declaratory and original precedents:* According to Salmond, a declaratory precedent is one which is merely the application of an already existing rule of law. An original precedent is one which creates and applies a new rule of law. In the case of a declaratory precedent, the rule is applied because it is already a law. In the case of an original precedent, it is law for the future because it is now applied. In the case of advanced countries, declaratory precedents are more numerous. The number of original precedents is small but their importance is very great. They alone develop the law of the country. They serve as good evidence of law for the future. A declaratory precedent is as good a source of law as an original precedent. The legal authority of both is exactly the same.

(b) *Persuasive precedents:* A persuasive precedent is one which the judges are not obliged to follow but which they will take into consideration and to which they will attach great weight as it seems to them to deserve. A persuasive precedent, therefore, is not a legal source of law; but is regarded as a historical source of law. Thus, in India, the decisions of one High Court are only persuasive precedents in the other High Courts. The rulings of the English and American Courts are persuasive precedents only. *Obiter dicta* also have only persuasive value.

(c) *Absolutely authoritative precedents:* An authoritative precedent is one which judges must follow whether they approve of it or not. Its binding force is absolute and the judge's discretion is altogether excluded as he must follow it. Such a decision has a legal claim to implicit obedience, even if the judge considers it wrong. Unlike a persuasive precedent which is merely historical, an authoritative precedent is a legal source of law.

Absolutely authoritative precedents in India: Every court in India is absolutely bound by the decisions of courts superior to itself. The subordinate courts are bound to follow the decisions of the High Court to which they are subordinate. A single judge of a High Court is bound by the decision of a bench of two or more judges. All courts are absolutely bound by decisions of the Supreme Court.

In England decisions of the House of Lords are absolutely binding not only upon all inferior courts but even upon itself. Likewise, the decisions of the

Court of Appeal are absolutely binding upon itself.

(d) *Conditionally authoritative precedents:* A conditionally authoritative precedent is one which, though ordinarily binding on the court before which it is cited, is liable to be disregarded in certain circumstances. The court is entitled to disregard a decision if it is a wrong one, i.e., contrary to law and reason. In India, for instance, the decision of a single Judge of the High Court is absolutely authoritative so far as subordinate judiciary is concerned, but it is only conditionally authoritative when cited before a Division Bench of the same High Court.

Doctrine of Stare Decisis

The doctrine of *stare decisis* means "adhere to the decision and do not unsettle things which are established". It is a useful doctrine intended to bring about certainty and uniformity in the law. Under the *stare decisis* doctrine, a principle of law which has become settled by a series of decisions generally is binding on the courts and should be followed in similar cases. In simple words, the principle means that like cases should be decided alike. This rule is based on public policy and expediency. Although generally the doctrine should be strictly adhered to by the courts, it is not universally applicable. The doctrine should not be regarded as a rigid and inevitable doctrine which must be applied at the cost of justice.

Ratio Decidendi

The underlying principle of a judicial decision, which is only authoritative, is termed as *ratio decidendi.* The proposition of law which is necessary for the decision or could be extracted from the decision constitutes the ratio. The concrete decision is binding between the parties to it. The abstract *ratio decidendi* alone has the force of law as regards the world at large. In other words, the authority of a decision as a precedent lies in its *ratio decidendi*.

Prof. Goodhart says that *ratio decidendi* is nothing more than the decision based on the material facts of the case.

Where an issue requires to be answered on principles, the principles which are deduced by way of abstraction of the material facts of the case eliminating the immaterial elements is known as *ratio decidendi* and such principle is not only applicable to that case but to other cases also which are of similar nature.

It is the *ratio decidendi* or the general principle which has the binding effect as a precedent, and not the *obiter dictum.* However, the determination or separation of *ratio decidendi* from *obiter dictum* is not so easy. It is for the judge to determine the *ratio decidendi* and to apply it on the case to be decided.

Obiter Dicta

The literal meaning of this Latin expression is "said by the way". The expression is used especially to denote those judicial utterances in the course of delivering a judgement which taken by themselves, were not strictly necessary for the decision of the particular issue raised. These statements thus go beyond the requirement of the particular case and have the force of persuasive precedents only. The judges are not bound to follow them although they can take advantage of them. They some times help the cause of the reform of law.

Obiter Dicta are of different kinds and of varying degrees of weight. Some *obiter dicta* are deliberate expressions of opinion given after consideration on a point clearly brought and argued before the court. It is quite often too difficult for lawyers and courts to see whether an expression is the ratio of judgement or just a causal opinion by the judge. It is open, no doubt, to other judges to give a decision contrary to such *obiter dicta.*

(iii) Statutes or Legislation

Legislation is that source of law which consists in the declaration or promulgation of legal rules by an authority duly empowered by the Constitution in that behalf. It is sometimes called *Jus scriptum* (written law) as contrasted with the customary law or *jus non-scriptum* (unwritten law). Salmond prefers to call it as "enacted law". Statute law or statutory law is what is created by legislation, for example, Acts of Parliament or of State Legislature. Legislation is either supreme or subordinate (delegated).

Supreme Legislation is that which proceeds from the sovereign power in the State or which derives its power directly from the Constitution. It cannot be replealed, annulled or controlled by any other legislative authority. *Subordinate Legislation* is that which proceeds from any authority other than the sovereign power. It is dependent for its continued existence and validity on some superior authority. The Parliament of India possesses the power of supreme legislation. Legislative powers have been given to the judiciary, as the superior courts are allowed to make rules for the regulation of their own procedure. The executive, whose main function is to enforce the law, is given in some cases the power to make rules. Such subordinate legislation is known as executive or delegated legislation. Municipal bodies enjoy by delegation from the legislature, a limited power of making regulations or bye-laws for the area under their jurisdiction. Sometimes, the State allows autonomous bodies like universities to make bye-laws which are recognised and enforced by courts of law.

The rule-making power of the executive is, however, hedged with limitations. The rules made by it are placed on the table of both Houses of Parliament for a stipulated period and this is taken as having been approved by the legislature. Such rules then become part of the enactment. Where a dispute arises as to the validity of the rules framed by the executive, courts have the power to sit in judgement whether any part of the rules so made is in excess of the power delegated by the parent Act.

In our legal system, Acts of Parliament and the Ordinances and other laws made by the President and Governors in so far as they are authorised to do so under the Constitution are supreme legislation while the legislation made by various authorities like Corporations, Municipalities, etc. under the authority of the supreme legislation are subordinate legislation.

(iv) Personal Law

In many cases, the courts are required to apply the personal law of the parties where the point at issue is not covered by any statutory law or custom. In the case of Hindus, for instance, their personal law is to be found in

(a) The *Shruti* which includes four Vedas.

(b) The *'Smritis'* which are recollections handed down by the *Rishi's* or ancient teachings and precepts of God, the commentaries written by various ancient authors on these *Smritis*. There are three main *Smritis*; the Codes of Manu, Yajnavalkya and Narada.

Hindus are governed by their personal law as modified by statute law and custom in all matters relating to inheritance, succession, marriage, adoption, co-parcenary, partition of joint family property, pious obligations of sons to pay their father's debts, guardianship, maintenance and religious and charitable endowments.

The personal law of Mohammedans is to be found in

(a) The holy *Koran*.

(b) The actions, percepts and sayings of the Prophet Mohammed which though not written during his life time were preserved by tradition and handed down by authorised persons. These are known as *Hadis*.

(c) *Ijmas*, i.e., a concurrence of opinion of the companions of the Prophet and his disciples.

(d) *Kiyas* or reasoning by analogy. These are analogical deductions derived from a comparison of the *Koran, Hadis* and *Ijmas* when none of these apply to a particular case.

(e) Digests and Commentaries on Mohammedan law, the most important and famous of them being the *Hedaya* which was composed in the 12th century and the *Fatawa Alamgiri* which was compiled by commands of the Mughal Emperor Aurangzeb Alamgiri.

Mohammedans are governed by their personal law as modified by statute law and custom in all matters relating to inheritance, wills, succession, legacies, marriage, dowery, divorce, gifts, wakfs, guardianship and pre-emption.

(B) Secondary Source of Indian Law

Justice, Equity and Good Conscience

The concept of "justice, equity and good conscience" was introduced by Impey's Regulations of 1781. In personal law disputes, the courts are required to apply the personal law of the defendant if the point at issue is not covered by any statute or custom.

In the absence of any rule of a statutory law or custom or personal law, the Indian courts apply to the decision of a case what is known as *"justice, equity and good conscience"*, which may mean the rules of English Law in so far as they are applicable to Indian society and circumstances.

The Ancient Hindu Law had its own versions of the doctrine of *justice, equity and good conscience.* In its modern version, *justice, equity and good conscience* as a source of law, owes its origin to the beginning of the British administration of justice in India. The Charters of the several High Courts established by the British Government directed that when the law was silent on a matter, they should decide the cases in accordance with *justice, equity and good conscience. Justice, equity and good conscience* have been generally interpreted to mean rules of English law on an analogous matter as modified to suit the Indian conditions and circumstances. The Supreme Court has stated that it is now well established that in the absence of any rule of Hindu Law, the courts have authority to decide cases on the principles of *justice, equity and good conscience* unless in doing so the decision would be repugnant to, or inconsistent with, any doctrine or theory of Hindu Law: (1951) 1 SCR 1135.

Since the main body of rules and principles of Indian law is an adaptation of English law, in the following pages the main sources of English law are discussed in some detail.

2. Sources of English Law

The chief sources of English law are (i) the Common Law, (ii) The Law Merchant, (iii) Equity, and (iv) the Statute Law.

(i) *Common Law:* The Common Law, in this context is the name given to those principles of law evolved by the judges in making decisions on cases that are brought before them. These principles have been built up over many years so as to form a complete statement of the law in particular areas. Thus, Common Law denotes that body of legal rules, the primary sources of which were the general immemorial customs, judicial decisions and text books on Jurisprudence. Common Law is unwritten law of England which is common to the whole of the realm.

(ii) *Law Merchant:* The Law Merchant is the most important source of the Merchantile Law. Law Merchant means those customs and usages which are binding on traders in their dealings with each other. But before a custom can have a binding force of law, it must be shown that such a custom is ancient, general as well as notorious and commands universal compliance. In all other cases, a custom has to be proved by the party claiming it.

(iii) *Principle of Equity:* Equity is a body of rules, the primary source of which was neither custom nor written law, but the imperative dictates of conscience and which had been set forth and developed in the Courts of Chancery. The procedure of Common Law Courts was very technical and dilatory. Action at Common Law could be commenced by first obtaining a writ or a process. The writs were limited in number and unless a person was able to bring his case within one of those writs, no action could lie at Common Law. In some cases, there was no remedy or inadequate remedy at Common Law. The King is considered as the fountain head of justice; when people were dissatisfied or aggrieved with the decision of the Common Law Court, they could always file a mercy petition with the King-in-Council. The King would refer these petitions to his Chancellor. The Chancellor, who was usually a Bishop, would dispose of these petitions not according to the rigid letter of the law but according to his own dictates of commonsense, natural justice and good conscience. The law so administered by the Chancellor came to be known as 'Equity' and such courts as 'Equity Courts'. These 'Equity Courts' acted on number of maxims e.g.,

1. *"He who seeks equity must do equity",*
2. *"He who comes to equity must come with clean hands".*

The Equity Courts had their separate existence from the Common Law Courts in England until the passing of the Judicature Act of 1873, when the separate existence of such courts was abolished and all High Courts were empowered to grant either or both the remedies (Common Law as well as Equity) according to the circumstances of each case.

Some of the important principles and remedies developed by Equity Courts

are recognition of the right of beneficiary to trust property, remedy of specific performance of contracts, equity of redemption in case of mortgages etc.

(iv) *Statute Law:* "Statute law is that portion of law which is derived from the legislation or enactment of Parliament or the subordinate and delegated legislative bodies." It is now a very important source of Mercantile Law. A written or statute law overrides unwritten law, i.e., both Common Law and Equity. Some of the important enactments in the domain of Mercantile Law are: The English Partnership Act, 1890, The English Sale of Goods Act,1893, Bankruptcy Act, 1914, Carriers Act, 1830, The English Companies Act, 1948 etc.

3. Mercantile or Commercial Law

There are many branches of law; viz.,

1. Constitutional Law
2. Administrative Law
3. Criminal Law
4. Civil Law
5. Mercantile or Commercial Law.

Mercantile Law is related to the commercial activities of the people of the society. It is that branch of law which is applicable to or concerned with trade and commerce in connection with various mercantile or business transactions. Mercantile Law is a wide term and embraces all legal principles concerning business transactions. The most important feature of such a business transaction is the existence of a valid agreement, express or implied, between the parties concerned.

Origin and growth of Mercantile Law in England: The Mercantile Law or Law Merchant or Lex Mercatorla is the name given to that part of law which grew up from the customs and usages of merchants or traders in England which eventually became a part of Common Law of England.

4. Sources of Mercantile Law

The following are the main sources of Mercantile Law:

1. The Law Merchant
2. Statute Law
3. Common Law
4. Principles of Equity.

These have already been discussed under the heading – Sources of English Law.

5. Mercantile Law in India

Prior to 1872, mercantile transactions were regulated by the law of the parties to the suit (i.e., Hindu Law, Mohammedan Law etc.). In 1872, the first attempt was made to codify and establish uniform principles of mercantile law when Indian Contract Act, 1872 was enacted. Since then, various Acts have been enacted to regulate transactions regarding partnership, sale of goods, negotiable instruments, etc.

6. Sources of Indian Mercantile Law

The main sources of Indian Mercantile Law are:

1. English Mercantile Law;
2. Acts enacted by Indian Legislature;
3. Judicial Decisions; and
4. Customs and Trade Usages.

English Mercantile Law: The Indian Mercantile Law is mainly an adaptation of English Mercantile Law. However, certain modifications wherever necessary, have been incorporated in it to provide for local customs and usages of trade and to suit Indian conditions. Its dependence on English Mercantile Law is so much that even now in the absence of provisions relating to any matter in the Indian Law, recourse is to be had to the English Mercantile Law.

Acts enacted by Indian Legislature or Statute Law: The following Acts enacted by the Indian legislature from time to time are important for the study of Indian Mercantile Law: (i) The Indian Contract Act, 1872, (ii) The Sale of Goods Act, 1930, (iii) The Indian Partnership Act, 1932, (iv) The Negotiable Instruments Act, 1881, (v) The Arbitration and Conciliation Act, 1996, (vi) The Insurance Act, 1938, (vii) The Carriers Act, 1865, (viii) The Presidency Towns Insolvency Act, 1909 and (ix) Provincial Insolvency Act, 1920.

Judicial Decisions: Judges interpret and explain the statutes. Whenever the law is silent on a point, the judge has to decide the case according to the principles of *justice, equity and good conscience*. It would be accepted in most systems of law that cases which are identical in their facts, should also be identical in their decisions. That principle ensures justice for the individual claimant and a measure of certainty for the law itself. The English legal system has developed a system of judicial precedent which requires the extraction of the legal principle from a particular judicial decision and, given the fulfilment of certain conditions, ensures that judges apply the principle in subsequent cases which are indistinguishable. The latter provision being termed “binding precedents”. Such decisions are called as precedents and become an important source of law (See Judicial Precedents at p.7). Prior to independence, the Privy Council of Great Britain was the final Court of Appeal and its decisions were binding on Indian Courts. After independence, the Supreme Court of India is the final Court of Appeal. But even then, the decisions of English Courts such as Privy Council and House of Lords are frequently referred to as precedents in deciding certain cases and in interpreting Indian Statutes.

Customs and Trade Usages: Most of the Indian Law has been codified. But even then, it has not altogether done away with customs and usages. Many Indian statutes make specific provisions to the effect that the rules of law laid down in a particular Act are subject to any special custom or usages of trade. For example, Section 1 of the Indian Contract Act, 1872, lays down that, “Nothing herein contained shall effect the provisions of any Statute, Act or Regulation not hereby expressly repealed, nor any usage or custom of trade, nor any incident of any contract, not inconsistent with the provisions of this Act”. Similarly Section 1 of the Negotiable Instruments Act, 1881, lays down that, “nothing herein contained... affects any local usage relating to any

instrument in any oriental language". It may be noted that the whole law relating to *Hundis* and the *Kachhi* and *Pakki Adat Systems* of Agency is based on custom and usage of trade as recognised and given legal effect to by courts of law in India.

SELF-TEST QUESTIONS

1. Discuss briefly the nature and meaning of "law".
2. What is the definition of "law" according to:
   (a) Historical school of law.
   (b) Sociological school of law.
   (c) Realistic school of law.
3. Discuss in brief Austin's theory of law and distinguish it with Kelsen's Pure supplementing of law.
4. What is Common Law, Equity and Lex Mercatoria? Discuss their contribution in supplementing the Common Law.
5. What are the sources of Indian Mercantile Law?
6. What is Customary Law? How will you classify customs?

Suggested Readings:

(1) An introduction to Jurisprudence (Legal Theory) — *B.N.M.P. Tripathi*
(2) Introduction of Jurisprudence with Selected Texts — *Dennis Lloyd*
(3) Essential Business Law (Law and the legal System) — *Peter Smith*

STUDY II

THE INDIAN CONTRACT ACT, 1872

MEANING AND NATURE OF CONTRACT

The Law of Contract constitutes the most important branch of Mercantile or Commercial Law. It affects everybody, more so, trade, commerce and industry. It may be said that the contract is the foundation of the civilized world.

The law relating to contract is governed by the Indian Contract Act, 1872. The Act came into force on the first day of September, 1872. The preamble to the Act says that it is an Act "to define and amend certain parts of the law relating to contract". It extends to the whole of India except the State of Jammu and Kashmir. The Act is by no means exhaustive on the law of contract. It does not deal with all the branches of the law of contract. Thus, contracts relating to partnership, sale of goods, negotiable instruments, insurance etc. are dealt with by separate Acts.

The Indian Contract Act mostly deals with the general principles and rules governing contracts. The Act is divisible into two parts. The first part (Section 1-75) deals with the general principles of the law of contract, and therefore applies to all contracts irrespective of their nature. The second part (Sections 124-238) deals with certain special kinds of contracts, namely contracts of Indemnity and Guarantee, Bailment, Pledge, and Agency.

The term contract has been defined by various authors in the following manner:

"A contract is an agreement creating and defining obligations between the parties". —*Salmond*

"A contract is an agreement enforceable at law, made between two or more persons, by which rights are acquired by one or more to acts or forbearances on the part of the other or others". —*Anson*

"Every agreement and promise enforceable at law is a contract".

—*Sir Fredrick Pollock*

The Indian Contract Act has defined contract in Section 2(h) as "an agreement enforceable by law".

These definitions indicate that a contract essentially consists of two distinct parts. First, there must be an agreement. Secondly, such an agreement must be enforceable by law. To be enforceable, an agreement must be coupled with an obligation.

A contract therefore, is a combination of the two elements: (1) an agreement and (2) an obligation.

Agreement

An agreement gives birth to a contract. As per Section 2(e) of the Indian Contract Act "every promise and every set of promises, forming the consideration for each other, is an agreement. It is evident from the definition given above that an agreement is based on a promise. What is a promise? According to Section 2(b) of the Indian Contract Act "when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted,

becomes a promise. An agreement, therefore, comes into existence when one party makes a proposal or offer to the other party and that other party signifies his assent thereto. In nutshell, an agreement is the sum total of offer and acceptance."

An analysis of the definition given above reveals the following characteristics of an agreement:

(a) *Plurality of persons:* There must be two or more persons to make an agreement because one person cannot enter into an agreement with himself.

(b) *Consensus ad idem:* The meeting of the minds is called *consensus-ad-idem.* It means both the parties to an agreement must agree about the subject matter of the agreement in the same sense and at the same time.

Obligation

An obligation is the legal duty to do or abstain from doing what one has promised to do or abstain from doing. A contractual obligation arises from a bargain between the parties to the agreement who are called the promisor and the promisee. Section 2(b) says that when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted; and a proposal when accepted becomes a promise. In broad sense, therefore, a contract is an exchange of promises by two or more persons, resulting in an obligation to do or abstain from doing a particular act, where such obligation is recognised and enforced by law.

Rights and Obligations

Where parties have made a binding contract, they have created rights and obligations between themselves. The contractual rights and obligations are correlative, e.g., A agrees with B to sell his car for Rs. 10,000 to him. In this example, the following rights and obligations have been created:

(i) A is under an obligation to deliver the car to B.

B has a corresponding right to receive the car.

(ii) B is under an obligation to pay Rs. 10,000 to A.

A has a correlative right to receive Rs. 10,000.

Agreements which are not Contracts

Agreements in which the idea of bargain is absent and there is no intention to create legal relations are not contracts. These are:

(a) *Agreements relating to social matters:* An agreement between two persons to go together to the cinema, or for a walk, does not create a legal obligation on their part to abide by it. Similarly, if I promise to buy you a dinner and break that promise, I do not expect to be liable to legal penalties. There cannot be any offer and acceptance to hospitality.

(b) *Domestic arrangements between husband and wife:* In *Balfour* v. *Balfour* (1919) 2 KB 571, a husband working in Ceylone, had agreed in writing to pay a housekeeping allowance to his wife living in England. On receiving information that she was unfaithful to him, he stopped the allowance: Held, he was entitled to do so. This was a mere domestic arrangement with no intention to create legally binding relations. Therefore, there was no contract.

Three consequences follow from the above discussion.

(i)To constitute a contract, the parties must intend to create legal relationship.

(ii) The law of contract is the law of those agreements which create obligations, and those obligations which have their source in agreement.

(iii) Agreement is the genus of which contract is the specie and, therefore, all contracts are agreements but all agreements are not contracts.

ESSENTIAL ELEMENTS OF A VALID CONTRACT

Section 10 of the Indian Contract Act, 1872 provides that "all agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void".

The essential elements of a valid contract are:

(i) An offer or proposal by one party and acceptance of that offer by another party resulting in an *agreement—consensus-ad-idem.*

(ii) An intention to create legal relations or an intent to have legal consequences.

(iii) The agreement is supported by a lawful consideration.

(iv) The parties to the contract are legally capable of contracting.

(v) Genuine consent between the parties.

(vi) The object and consideration of the contract is legal and is not opposed to public policy.

(vii) The terms of the contract are certain.

(viii) The agreement is capable of being performed i.e., it is not impossible of being performed.

Therefore, to form a valid contract there must be (1) an agreement, (2) based on the genuine consent of the parties, (3) supported by a lawful consideration, (4) made for a lawful object, and (iv) between the competent parties.

(a) Offer or Proposal and Acceptance

One of the early steps in the formation of a contract lies in arriving at an agreement between the contracting parties by means of an offer and acceptance. Thus, when one party (the offeror) makes a definite proposal to another party (the offeree) and the offeree accepts it in its entirety and without any qualification, there is a meeting of the minds of the parties and a contract comes into being, assuming that all other elements are also present.

What is an Offer or a Proposal?

A proposal is also termed as an offer. The word 'proposal' is synonymous with the English word "offer". An offer is a proposal by one person, whereby he expresses his willingness to enter into a contractual obligation in return for a promise, act or forbearance. Section 2(a) of the Indian Contract Act defines proposal or offer as "when one person signifies to another his willingness to do or abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal". The person making the proposal or offer is called the *proposer or offeror* and the person to whom the proposal is made is called the *offeree*.

Rules Governing Offers

A valid offer must comply with the following rules:

(a) An offer must be clear, definite, complete and final. It must not be vague. For example, a promise to pay an increased price for a horse if it proves lucky to promisor, is too vague and is not binding.

(b) An offer must be communicated to the offeree. An offer becomes effective only when it has been communicated to the offeree so as to give him an opportunity to accept or reject the same.

(c) The communication of an offer may be made by express words-oral or written-or it may be implied by conduct. A offers his car to B for Rs. 10,000. It is an express offer. A bus plying on a definite route goes along the street. This is an implied offer on the part of the owners of the bus to carry passengers at the scheduled fares for the various stages.

(d) The communication of the offer may be general or specific. Where an offer is made to a specific person it is called specific offer and it can be accepted only by that person. But when an offer is addressed to an uncertain body of individuals i.e. the world at large, it is a general offer and can be accepted by any member of the general public by fulfilling the condition laid down in the offer. The leading case on the subject is *Carlill* v. *Carbolic Smoke Ball Co.* The company offered by advertisement, a reward of # 100 to anyone who contacted influenza after using their smoke ball in the specified manner. Mrs. Carlill did use smoke ball in the specified manner, but was attacked by influenza. She claimed the reward and it was held that she could recover the reward as general offer can be accepted by anybody. Since this offer is of a continuing nature, more than one person can accept it and can even claim the reward. But if the offer of reward is for seeking some information or seeking the restoration of missing thing, then the offer can be accepted by one individual who does it first of all. The condition is that the claimant must have prior knowledge of the reward before doing that act or providing that information.

Example: A advertise in the newspapers that he will pay rupees one thousand to anyone who restores to him his lost son. B without knowing of this reward finds A's lost son and restore him to A. In this case since B did not know of the reward, he cannot claim it from A even though he finds A's lost son and restores him to A.

In India also, in the case of *Harbhajan Lal* v. *Harcharan Lal* (AIR 1925 All. 539), the same rule was applied. In this case, a young boy ran away from his fathers home. The father issued a pamphlet offering a reward of Rs. 500 to anybody who would bring the boy home. The plaintiff saw the boy at a railway station and sent a telegram to the boys father. It was held that the handbill was an offer open to the world at large and was capable to acceptance by any person who fulfilled the conditions contained in the offer. The plaintiff substantially performed the conditions and was entitled to the reward offered.

An Offer must be Distinguished from

(a) *An invitation to treat or an invitation to make an offer:* e.g., an auctioneers request for bids (which are offered by the bidders), the display of goods in a shop window with prices marked upon them, or the display of priced goods in a self-

service store or a shopkeepers catalogue of prices are invitations to an offer.

(b) *A mere statement of intention:* e.g., an announcement of a coming auction sale. Thus, a person who attended the advertised place of auction could not sue for breach of contract if the auction was cancelled (*Harris* v. *Nickerson* (1873) L.R. 8 QB 286).

(c) *A mere communication of information in the course of negotiation:* e.g., a statement of the price at which one is prepared to consider negotiating the sale of piece of land (*Harvey* v. *Facey* (1893) A.C. 552).

An offer that has been communicated properly continues as such until it lapses, or until it is revoked by the offeror, or rejected or accepted by the offeree.

Lapse of Offer

Section 6 deals with various modes of lapse of an offer. It states that an offer lapses if—

(a) it is not accepted within the specified time (if any) or after a reasonable time, if none is specified.

(b) it is not accepted in the mode prescribed or if no mode is prescribed in some usual and reasonable manner, e.g., by sending a letter by mail when early reply was requested;

(c) the offeree rejects it by distinct refusal to accept it;

(d) either the offeror or the offeree dies before acceptance;

(e) the acceptor fails to fulfill a condition precedent to an acceptance.

(f) the offeree makes a counter offer, it amounts to rejection of the offer and an offer by the offeree may be accepted or rejected by the offeror.

Revocation of Offer by the Offeror

An offer may be revoked by the offeror at any time before acceptance.

Like any offer, revocation must be communicated to the offeree, as it does not take effect until it is actually communicated to the offeree. Before its actual communication, the offeree, may accept the offer and create a binding contract. The revocation must reach the offeree before he sends out the acceptance.

An offer to keep open for a specified time (option) is not binding unless it is supported by consideration.

Acceptance

A contract emerges from the acceptance of an offer. Acceptance is the act of assenting by the offeree to an offer. Under Section 2(b) of the Contract Act when a person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted becomes a promise..

Rules Governing Acceptance

(a) Acceptance may be express i.e. by words spoken or written or implied from the conduct of the parties.

(b) If a particular method of acceptance is prescribed, the offer must be accepted in the prescribed manner.

(c) Acceptance must be unqualified and absolute and must correspond with all

the terms of the offer.

(d) A counter offer or conditional acceptance operates as a rejection of the offer and causes it to lapse, e.g., where a horse is offered for Rs. 1,000 and the offeree counter-offers Rs. 990, the offer lapses by rejection.

(e) Acceptance must be communicated to the offeror, for acceptance is complete the moment it is communicated. Where the offeree merely intended to accept but does not communicate his intention to the offeror, there is no contract. Mere mental acceptance is not enough.

(f) Mere silence on the part of the offeree does not amount to acceptance.

Ordinarily, the offeror cannot frame his offer in such a way as to make the silence or inaction of the offeree as an acceptance. In other words, the offeror can prescribe the mode of acceptance but not the mode of rejection.

In *Felthouse* v. *Bindley* (1865), F offered by letter to buy his nephews horse for £ 30 saying: "If I hear no more about him I shall consider the horse is mine at £ 30". The nephew did not reply, but he told an auctioneer who was selling his horses not to sell that particular horse because it was sold to his uncle. The auctioneer inadvertently sold the horse. *Held:* F had no claim against the auctioneer because the horse had not been sold to him, his offer of £ 30 not having been accepted.

(g) If the offer is one which is to be accepted by being acted upon, no communication of acceptance to the offeror is necessary, unless communication is stipulated for in the offer itself.

Thus, if a reward is offered for finding a lost dog, the offer is accepted by finding the dog after reading about the offer, and it is unnecessary before beginning to search for the dog to give notice of acceptance to the offeror.

(h) Acceptance must be given within a reasonable time and before the offer lapses or is revoked. An offer becomes irrevocable by acceptance.

An acceptance never precedes an offer. There can be no acceptance of an offer which is not communicated. Similarly, performance of conditions of an offer without the knowledge of the specific offer, is no acceptance. Thus in *Lalman Shukla* v. *Gauri Dutt* (1913), where a servant brought the boy without knowing of the reward, he was held not entitled to reward because he did not know about the offer.

Standing Offers

Where a person offers to another to supply specific goods, up to a stated quantity or in any quantity which may be required, at a certain rate, during a fixed period, he makes a standing offer. Thus, a tender to supply goods as and when required, amounts to a standing offer.

A standing offer or a tender is of the nature of a continuing offer. An acceptance of such an offer merely amounts to an intimation that the offer will be considered to remain open during the period specified and that it will be accepted from time to time by placing order for specified quantities. Each successive order given, while the offer remains in force, is an acceptance of the standing offer as to the quantity ordered, and creates a separate contract. It does not bind either party unless and until such

orders are given.

Where P tendered to supply goods to L upto a certain amount and over a certain period, L's order did not come up to the amount expected and P sued for breach of contract *Held:* Each order made was a separate contract and P was bound to fulfill orders made, but there was no obligation on L to make any order to all (*Percival* Ltd. v. *L.C.C*. (1918).

Tickets

Tickets purchased for entrance into places of amusement, or tickets issued by railways or bus companies, clock-room tickets, and many other contracts set out in printed documents contain numerous terms, of many of which the party receiving the ticket or document is ignorant. If a passenger on a railway train receives a ticket on the face of which is printed "this ticket is issued subject to the notices, regulations and conditions contained in the current time-tables of the railway", the regulations and conditions referred to are deemed to be communicated to him and he is bound by them whether or not he has read them. He is bound even if he is illiterate and unable to read them. But it is important that the notice of the conditions is contemporaneous with the making of the contract and not after the contract has been made.

Contracts by Post

Contracts by post are subject to the same rules as others, but because of their importance, these are stated below separately:

(a) An offer by post may be accepted by post, unless the offeror indicates anything to the contrary.

(b) An offer is made only when it actually reaches the offeree and not before, i.e., when the letter containing the offer is delivered to the offeree.

(c) An acceptance is made as far as the offeror is concerned, as soon as the letter containing the acceptance is posted, to offerors correct address; it binds the offeror, but not the acceptor.

An acceptance binds the acceptor only when the letter containing the acceptance reaches the offeror. The result is that the acceptor can revoke his acceptance before it reaches the offeror.

(d) An offer may be revoked before the letter containing the acceptance is posted. An acceptance can be revoked before it reaches the offeror.

Contracts over the Telephone

Contracts over the telephone are regarded the same in principle as those negotiated by the parties in the actual presence of each other. In both cases an oral offer is made and an oral acceptance is expected. It is important that the acceptance must be audible, heard and understood by the offeror. If during the conversation the telephone lines go "dead" and the offeror does not hear the offerees word of acceptance, there is no contract at the moment. If the whole conversation is repeated and the offeror hears and understands the words of acceptance, the contract is complete (*Kanhaiyalal* v. *Dineshwarchandra* (1959) AIR, M.P. 234).

(b) Intention to Create Legal Relations

The second essential element of a valid contract is that there must be an intention among the parties that the agreement should be attached by legal consequences and create legal obligations. If there is no such intention on the part of the parties, there is no contract between them. Agreements of a social or domestic nature do not contemplate legal relationship. As such they are not contracts.

A proposal or an offer is made with a view to obtain the assent to the other party and when that other party expresses his willingness to the act or abstinence proposed, he accepts the offer and a contract is made between the two. But both offer and acceptance must be made with the intention of creating legal relations between the parties. The test of intention is objective. The Courts seek to give effect to the presumed intention of the parties. Where necessary, the Court would look into the conduct of the parties, for much can be inferred from the conduct. The Court is not concerned with the mental intention of the parties, but rather with what a reasonable man would say, was the intention of the parties, having regard to all the circumstances of the case.

For example, if two persons agree to assist each other by rendering advice, in the pursuit of virtue, science or art, it cannot be regarded as a contract. In commercial and business agreements, the presumption is usually that the parties intended to create legal relations. But this presumption is rebuttable which means that it must be shown that the parties did not intend to be legally bound.

(c) Consideration

Need for Consideration

Consideration is one of the essential elements of a valid contract. The requirement of consideration stems from the policy of extending the arm of the law to the enforcement of mutual promises of parties. A mere promise is not enforceable at law. For example, if A promises to make a gift of Rs. 500 to B, and subsequently changes his mind, B cannot succeed against A for breach of promise, as B has not given anything in return. It is only when a promise is made for something in return from the promisee, that such promise can be enforced by law against the promisor. This something in return is the consideration for the promise.

Definition of Consideration

Sir Fredrick Pollock has defined consideration “as an act or forbearance of one party, or the promise thereof is the price for which the promise of the other is bought”.

It is “some right, interest, profit, or benefit accruing to one party or some forbearance, detriment, loss or responsibility, given, suffered or undertaken by the other” (*Currie* v. *Misa* (1875) L.R. 10 Ex. 153).

Section 2(d) of the Indian Contract Act, 1872 defines consideration thus: “when at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing something, such act or abstinence or promise is called a consideration for the promise”.

The fundamental principle that consideration is essential in every contract, is laid

down by both the definitions but there are some important points of difference in respect of the nature and extent of consideration and parties to it under the two systems of law:

(a) *Consideration at the desire of the promisor:* Section 2(d) of the Act begins with the statement that consideration must move at the desire or request of the promisor. This means that whatever is done must have been done at the desire of the promisor and not voluntarily or not at the desire of a third party. If A rushes to B's help whose house is on fire, there is no consideration but a voluntary act. But if A goes to B's help at B's request, there is good consideration as B did not wish to do the act gratuitously.

(b) *Consideration may move from the promisee or any other person:* In English law, consideration must move from the promisee, so that a stranger to the consideration cannot sue on the contract. A person seeking to enforce a simple contract must prove in court that he himself has given the consideration in return for the promise he is seeking to enforce.

In Indian law, however, consideration may move from the promisee or any other person, so that a stranger to the consideration may maintain a suit. In *Chinnaya* v. *Ramaya,* (1882) 4 Mad. 137, a lady by a deed of gift made over certain property to her daughter directing her to pay an annuity to the donors brother as had been done by the donor herself before she gifted the property. On the same day, her daughter executed in writing in favour of the donors brother agreeing to pay the annuity. Afterwards the donee (the daughter) declined to fulfil her promise to pay her uncle saying that no consideration had moved from him. The Court, however, held that the uncle could sue even though no part of the consideration received by his niece moved from him. The consideration from her mother was sufficient consideration.

Privity of Contract

A stranger to a contract cannot sue both under the English and Indian law for want of privity of contract. The following illustration explains this point.

In *Dunlop Pneumatic Tyre Co.* v. *Selfridge* Ltd. (1915) A.C. 847, D supplied tyres to a wholesaler X, on condition that any retailer to whom X re-supplied the tyres should promise X, not to sell them to the public below Ds list price. X supplied tyres to S upon this condition, but nevertheless S sold the tyres below the list price. Held: There was a contract between D and X and a contract between X and S. Therefore, D could not obtain damages from S, as D had not given any consideration for Ss promise to X nor was he party to the contract between D and X.

Thus, a person who is not a party to a contract cannot sue upon it even though the contract is for his benefit. A, who is indebted to B, sells his property to C, and C the purchaser of the property, promises to pay off the debt to B. In case C fails to pay B, B has no right to sue C for there is no privity of contract between B and C.

The leading English case on the point is *Tweddle* v. *Atkinson* (1861) 1B and Section 393. In this case, the father of a boy and the father of a girl who was to be married to the boy, agreed that each of them shall pay a sum of money to the boy who was to take up the new responsibilities of married life. After the demise of both the contracting parties, the boy (the husband) sued the executors of his father-in-law upon the agreement between his father-in-law and his father. *Held:* the suit was not maintainable as the boy was not a party to the contract.

Exception to the doctrine of privity of contract: Both the Indian law and the English law recognize certain exceptions to the rule that a stranger to a contract cannot sue on the contract. In the following cases, a person who is not a party to a contract can enforce the contract:

(i) A beneficiary under an agreement to create a trust can sue upon the agreement, though not a party to it, for the enforcement of the trust so as to get the trust executed for his benefit. In *Khawaja Muhammad* v. *Hussaini Begum,* (1910) 32 All. 410, it was held that where a Mohammedan lady sued her father-in- law to recover arrears of allowance payable to her by him under an agreement between him and her own father in consideration of her marriage, she could enforce the promise in her favour insofar as she was a beneficiary under the agreement to make a settlement in her favour, and she was claiming as beneficiary under such settlement.

(ii) An assignee under an assignment made by the parties, or by the operation of law (e.g. in case of death or insolvency), can sue upon the contract for the enforcement of his rights, tittle and interest. But a mere nominee (i.e., the person for whose benefit another has insured his own life) cannot sue on the policy because the nominee is not an assignee.

(iii) In cases of family arrangements or settlements between male members of a Hindu family which provide for the maintenance or expenses for marriages of female members, the latter though not parties to the contract, possess an actual beneficial right which place them in the position of beneficiaries under the contract, and can therefore, sue.

(iv) In case of acknowledgement of liability, e.g., where A receives money from B for paying to C, and admits to C the receipt of that amount, then A constitutes himself as the agent of C.

(v) Whenever the promisor is by his own conduct estopped from denying his liability to perform the promise, the person who is not a party to the contract can sue upon it to make the promisor liable.

(vi) In cases where a person makes a promise to an individual for the benefit of third party and creates a charge on certain immovable property for the purpose, the third party can enforce the promise though, he is stranger to the contract.

Kinds of Consideration

Consideration may be:

(a) *Executory or future* which means that it makes the form of promise to be performed in the future, e.g., an engagement to marry someone; or

(b) *Executed or present* in which it is an act or forbearance made or suffered for a promise. In other words, the act constituting consideration is wholly or completely performed, e.g., if A pays today Rs. 100 to a shopkeeper for goods which are promised to be supplied the next day, A has executed his consideration but the shopkeeper is giving executory consideration—a promise to be executed the following day. If the price is paid by the buyer and the goods are delivered by the seller at the same time, consideration is executed by both the parties.

(c) Past which means a past act or forbearance, that is to say, an act

constituting consideration which took place and is complete (wholly executed) before the promise is made.

According to English law, a consideration may be executory or executed but never past. The English law is that past consideration is no consideration. *The Indian law recognizes all the above three kinds of consideration.*

Rules Governing Consideration

(a) Every simple contact must be supported by valuable consideration otherwise it is formally void subject to some exceptions.

(b) Consideration may be an act of abstinence or promise.

(c) There must be mutuality i.e., each party must do or agree to do something. A gratuitous promise as in the case of subscription for charity, is not enforceable. For example, where A promises to subscribe Rs. 5,000 for the repair of a temple, and then refuses to pay, no action can be taken against him.

(d) Consideration must be real, and not vague, indefinite, or illusory, e.g., a son's promise to "stop being a nuisance" to his father, being vague, is no consideration.

(e) Although consideration must have some value, it need not be adequate i.e., a full return for the promise. Section 25 (Exp. II) clearly provides that "an agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate". It is upon the parties to fix their own prices. For example, where A voluntarily agreed to sell his motor car for Rs. 500 to B, it became a valid contract despite the inadequancy of the consideration.

(f) Consideration must be lawful, e.g., it must not be some illegal act such as paying someone to commit a crime. If the consideration is unlawful, the agreement is void.

(g) Consideration must be something more than the promisee is already bound to do for the promisor. Thus, an agreement to perform an existing obligation made with the person to whom the obligation is already owed, is not made for consideration. For example, if a seaman deserts his ship so breaking his contract of service and is induced to return to his duty by the promise for extra wages, he cannot later sue for the extra wages since he has only done what he had already contracted for: *Stilk* v. *Myrick* (1809).

When Consideration not Necessary

The general rule is that an agreement made without consideration is void. But Section 25 of the Indian Contract Act lays down certain exceptions which make a promise without consideration valid and binding. Thus, an agreement without consideration is valid:

1. If it is expressed in writing and registered and is made out of natural love and affection between parties standing in a near relation to each other; or
2. If it is made to compensate a person who has already done something voluntarily for the promisor, or done something which the promisor was legally compellable to do; or
3. If it is a promise in writing and signed by the person to be charged therewith,

or by his agent, to pay a debt barred by the law of limitation.

4. Besides, according to Section 185 of the Indian Contract Act, consideration is not required to create an agency.
5. In the case of gift actually made, no consideration is necessary. There need not be nearness of relation and even if it is, there need not be any natural love and affection between them.

The requirements in the above exceptions are noteworthy. The first one requires written and registered promise. The second may be oral or in writing and the third must be in writing.

Illustrations

A, for natural love and affection, promises to give his son B Rs. 10,000. A put his promise to B into writing and registered it. This is a contract.

A registered agreement between a husband and his wife to pay his earnings to her is a valid contract, as it is in writing, is registered, is between parties standing in near relation, and is for love and affection (*Poonoo Bibi* v. *Fyaz Buksh*, (1874) 15 Bom L.R. 57).

But where a husband by a registered document, after referring to quarrels and disagreement between himself and his wife, promised to pay his wife a sum of money for her maintenance and separate residence, it was held that the promise was unenforceable, as it was not made for love and affection (*Rajluckhy Deb* v. *Bhootnath* (1900) 4 C.W.N. 488).

Whether Gratuitous Promise can be Enforced

A gratuitous promise to subscribe to a charitable cause cannot be enforced, but if the promisee is put to some detriment as a result of his acting on the faith of the promise and the promisor knew the purpose and also knew that on the faith of the subscription an obligation might be incurred, the promisor would be bound by promise (*Kedar Nath* v. *Gorie Mohan* 64).

It may be noted that it is not necessary that the promisor should benefit by the consideration, it is sufficient if the promisee does some act from which a third person is benefited and he would not have done that act but for the promise of the promisor.

For example, Y requests X for loan, who agrees to give loan to Y if S gives guarantee of repayment of the loan. S gives such a guarantee of repayment by Y. Thereupon X gives loan to Y. Here S will be promisor and X the promisee, but from X's action, benefit is derived by Y and not by S. X would not have given the loan to Y had S not given the guarantee of repayment of loan. Thus, the benefit conferred on Y by X at the request of S is a sufficient consideration on the part of X as against the promise of S to repay the loan. Alternatively, it may be said that the detriment which X suffered by giving loan to Y at the request of S is sufficient consideration on the part of X in respect of the promise of S to repay the loan.

Consideration therefore, is some detriment to the promisee or some benefit to the promisor. Detriment to one person and benefit to the other are the same things looked from two angles. Ordinarily a promisor is not bound by his promise, unless some consideration is offered by the promisee.

Terms Must be Certain

It follows from what has been explained in relation to offer, acceptance and consideration that to be binding, an agreement must result in a contract. That is to say, the parties must agree on the terms of their contract. They must make their intentions clear in their contract. The Court will not enforce a contract the terms of which are uncertain. Thus, an agreement to agree in the future *(a contract to make a contract)* will not constitute a binding contract e.g., a promise to pay an actress a salary to be *"mutually agreed between us"* is not a contract since the salary is not yet agreed: *Loftus* v. *Roberts* (1902).

Similarly, where the terms of a final agreement are too vague, the contract will fail for uncertainty. Hence, the terms must be definite or capable of being made definite without further agreement of the parties.

The legal maxim, therefore, is *"a contract to contract is not a contract".* If you agree "subject to contract" or "subject to agreement", the contract does not come into existence, for there is no definite or unqualified acceptance.

Resume

Thus, a contract is always based upon:

(i) Agreement *(consensus ad idem)* an unqualified acceptance of a definite offer;

(ii) An intent to create legal obligations; and

(iii) Consideration.

FLAWS IN CONTRACT

There may be the circumstances under which a contract made under these rules may still be bad, because there is a flaw, vice or error somewhere. As a result of such a flaw, the apparent agreement is not a real agreement.

Where there is no real agreement, the law has three remedies:

Firstly: The agreement may be treated as of no effect and it will then be known as void agreement.

Secondly: The law may give the party aggrieved the option of getting out of his bargain, and the contract is then known as voidable.

Thirdly: The party at fault may be compelled to pay damages to the other party.

(a) Void Agreement

A void agreement is one which is destitute of all legal effects. It cannot be enforced and confers no rights on either party. It is really not a contract at all, it is non-existent. Technically the words 'void contract' are a contradiction in terms. But the expression provides a useful label for describing the situation that arises when a 'contract' is claimed but in fact does not exist. For example, a minors contract is void.

(b) Voidable Contract

A voidable contract is one which a party can put to an end. He can exercise his option, if his consent was not free. The contract will, however be binding, if he does

not exercise his option to avoid it within a reasonable time. The consent of a party is not free and so he is entitled to avoid the contract, if he has given misrepresentation, fraud, coercion or undue influence.

(c) Illegal Agreement

An illegal agreement is one which, like the void agreement has no legal effects as between the immediate parties. Further, transactions collateral to it also become tainted with illegality and are, therefore, not enforceable. Parties to an unlawful agreement cannot get any help from a Court of law, for no polluted hands shall touch the pure fountain of justice. On the other hand, a collateral transaction can be supported by a void agreement.

For example, one party may have deceived the other party, or in some other way there may be no genuine consent. The parties may be labouring under a mistake, or one or both the parties may be incapable of making a contract. Again, the agreement may be illegal or physically impossible. All these are called "the FLAWS in contract or the *VICES* of contract".

The chief flaws in contract are:

(i) Incapacity
(ii) Mistake
(iii) Misrepresentation
(iv) Fraud
(v) Undue Influence
(vi) Coercion
(vii) Illegality
(viii) Impossibility.

(i) Flaw in Capacity — Capacity and Persons

In law, persons are either natural or artificial. Natural persons are human beings and artificial persons are corporations. Contractual capacity or incapacity is an incident of personality.

The general rule is that all natural persons have full capacity to make binding contracts. But the Indian Contract Act, 1872 admits an exception in the case of:

(i) minors,
(ii) lunatics, and
(iii) persons disqualified from contracting by any law to which they are subject.

These persons are not competent to contract. Section 11 provides that every "person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject". A valid agreement requires that both the parties should understand the legal implications of their conduct. Thus, both must have a mature mind. The legal yardstick to measure maturity according to the law of contract is, that both should be major and of sound mind and if not, the law would presume that the maturity of their mind has not reached to the extent of visualising

the pros and cons of their acts, hence, a bar on minors and lunatics competency to contract.

The contractual capacity of a corporation depends on the manner in which it was created.

Minor's Contract

According to the Indian Majority Act, 1875, a minor is a person, male or female, who has not completed the age of 18 years. In case a guardian has been appointed to the minor or where the minor is under the guardianship of the Court of Wards, the person continues to be a minor until he completes his age of 21 years. According to the Indian Contract Act, no person is competent to enter into a contract who is not of the age of majority. It was finally laid down by the Privy Council in the leading case of *Mohiri Bibi* v. *Dharmodas Ghose,* (1903) 30 Cal. 539, that a minor has no capacity to contract and minors contract is absolutely void. In this case, X, a minor borrowed Rs. 20,000 from Y, a money lender. As a security for the money advanced, X executed a mortgage in Y's favour. When sued by Y, the Court held that the contract by X was void and he cannot be compelled to repay the amount advanced by him.

Indian Courts have applied this decision to those cases where the minor has incurred any liability or where the liabilities on both sides are outstanding. In such cases, the minor is not liable. But if the minor has carried out his part of the contract, then, the Courts have held, that he can proceed against the other party. The rationale is to protect minors interest. According to the Transfer of Property Act, a minor cannot transfer property but he can be a transferee (person accepting a transfer). This statutory provision is an illustration of the above principle.

The following points must be kept in mind with respect to minors contract:

(a) A minor's contract is altogether void in law, and a minor cannot bind himself by a contract. If the minor has obtained any benefit, such as money on a mortgage, he cannot be asked to repay, nor can his mortgaged property be made liable to pay.

(b) Since the contract is void *ab initio*, it cannot be ratified by the minor on attaining the age of majority.

(c) Estoppel is an important principle of the law of evidence. To explain, suppose X makes a statement to Y and intends that the latter should believe and act upon it. Later on, X cannot resile from this statement and make a new one.

In otherwords, X will be estopped from denying his previous statement. But a minor can always plead minority and is not estopped from doing so even where he had produced a loan or entered into some other contract by falsely representing that he was of full age, when in reality he was a minor.

But where the loan was obtained by fraudulent representation by the minor or some property was sold by him and the transactions are set aside as being void, the Court may direct the minor to restore the property to the other party.

For example, a minor fraudulently overstates his age and takes delivery of a motor car after executing a promissory note in favour of the trader for its price. The minor cannot be compelled to pay the amount to the promissory note, but the Court on equitable grounds may order the minor to return the car to the trader, if it is still with the minor.

Thus, according to Section 33 of the Specific Relief Act, 1963 the Court may, if the minor has received any benefit under the agreement from the other party require him to restore, so far as may be such benefit to the other party, to the extent to which he or his estate has been benefited thereby.

(d) A minors estate is liable to pay a reasonable price for necessaries supplied to him or to anyone whom the minor is bound to support (Section 68 of the Act).

The necessaries supplied must be according to the position and status in life of the minor and must be things which the minor actually needs. The following have also been held as necessaries in India.

Costs incurred in successfully defending a suit on behalf of a minor in which his property was in jeopardy; costs incurred in defending him in a prosecution; and money advanced to a Hindu minor to meet his marriage expenses have been held to be necessaries.

(e) An agreement by a minor being void, the Court will never direct specific performance of the contract.

(f) A minor can be an agent, but he cannot be a principal nor can he be a partner. He can, however, be admitted to the benefits of a partnership.

(g) Since a minor is never personally liable, he cannot be adjudicated as an insolvent.

(h) An agreement by a parent or guardian entered into on behalf of the minor is binding on him provided it is for his benefit or is for legal necessity. For, the guardian of a minor, may enter into contract for marriage on behalf of the minor, and such a contract would be good in law and an action for its breach would lie, if the contract is for the benefit of the minor (*Rose Fernandez* v. *Joseph Gonsalves,* 48 Bom. L. R. 673) e.g., if the parties are of the community among whom it is customary for parents to contract marriage for their children. The contract of apprenticeship is also binding.

However, it has been held that an agreement for service, entered into by a father on behalf of his daughter who is a minor, is not enforceable at law (*Raj Rani* v. *Prem Adib,* (1948) 51 Bom. L.R. 256).

Lunatics Agreement (Section 2)

A person of unsound mind is a lunatic. That is to say for the purposes of making contract, a person is of unsound mind if at the time when he makes the contract, he is incapable of understanding it and of forming rational judgment as to its effect upon his interests.

A person unsound mind cannot enter into a contract. A lunatics agreement is therefore void. But if he makes a contract when he is of sound mind, i.e., during lucid intervals, he will be bound by it.

A sane man who is delirious from fever, or who is so drunk that he cannot understand the terms of a contract, or form a rational judgement as to its effect on his interests cannot contract whilst such delirium or state of drunkenness lasts. A person under the influence of hypnotism is temporarily of unsound mind. Mental decay brought by old age or disease also comes within the definition.

Agreement by persons of unsound mind are void. But for necessaries supplied to

a lunatic or to any member of his family, the lunatics estate, if any, will be liable. There is no personal liability incurred by the lunatic.

If a contract entered into by a lunatic or person of unsound mind is for his benefit, it can be enforced (for the benefit) against the other party (*Jugal Kishore* v. *Cheddu,* (1903) I All. L.J 43).

Persons Disqualified from Entering into Contract

Some statues disqualify certain persons governed by them, to enter into a contract. For example, Oudh Land Revenue Act provides that where a person in Oudh is declared as a 'disqualified proprietor under the Act, he is incompetent to alienate his property.

Alien Enemies

A person who is not an Indian citizen is an alien. An alien may be either an alien friend or a foreigner whose sovereign or State is at peace with India, has usually contractual capacity of an Indian citizen. On the declaration of war between his country and India he becomes an alien enemy. A contract with an alien enemy becomes unenforceable on the outbreak of war.

For the purposes of civil rights, an Indian citizen of the subject of a neutral state who is *voluntarily* resident in hostile territory or is carrying on business there is an alien enemy. Trading with an alien enemy is considered illegal, being against public policy.

Foreign Sovereigns and Ambassadors

Foreign sovereigns and accredited representatives of foreign states, i.e., Ambassadors, High Commissioners , enjoy a special privilege in that they cannot be sued in Indian Courts, unless they voluntarily submit to the jurisdiction of the Indian Courts. Foreign Sovereign Governments can enter into contracts through agents residing in India. In such cases the agent becomes personally responsible for the performance of the contracts.

Professional Persons

In England, barristers-at law are prohibited by the etiquette of their profession from suing for their fees. So also are the Fellow and Members of the Royal College of Physicians and Surgeons. But they can sue and be sued for all claims other than their professional fees. In India, there is no such disability and a barrister, who is in the position of an advocate with liberty both to act and plead, has a right to contract and to sue for his fees (*Nihal Chand* v. *Dilawar Khan*, 1933 All. L.R. 417).

Corporations

A corporation is an artificial person created by law, e.g., a company registered under the Companies Act, public bodies created by statute, such as Municipal Corporation of Delhi. A corporation exists only in contemplation of law and has no physical shape or form.

The Indian Contract Act does not speak about the capacity of a corporation to enter into a contract. But if properly incorporated, it has a right to enter into a contract. It can sue and can be sued in its own name. There are some contracts into which a corporation cannot enter without its seal, and others not at all. A company,

for instance, cannot contract to marry. Further, its capacity and powers to contract are limited by its charter or memorandum of association. Any contract beyond such power in ultra vires and void.

Married Women

In India there is no difference between a man and a woman regarding contractual capacity. A woman married or single can enter into contracts in the same ways as a man. She can deal with her property in any manner she likes, provided, of course, she is a major and is of sound mind.

Under the English law, before the passing of the Law Reform (Married Women and Tortfeasors) Act, 1935, a husband was responsible for his wifes contracts but since 1935 this liability no longer arises unless the wife is acting as the husbands agent. Now, therefore, even in England a married woman has full contractual capacity, and can sue and be sued in her own name.

Flaw in Consent

The basis of a contract is agreement, i.e., mutual consent. In other words, the parties should mean the something in the same sense and agree voluntarily. It is when there is consent, that the parties are said to be consensus ad idem i.e. their minds have met. Not only consent is required but it must be a free consent. Consent is not free when it has been caused by coercion, undue influence, misrepresentation, fraud or mistake. These elements if present, may vitiate the contract.

When this consent is wanting, the contract may turn out to be void or voidable according to the nature of the flaw in consent. Where there is no consent, there can be no contract as in the case of mutual mistake. Where there is consent, but it is not free, a contract is generally voidable at the option of the party whose consent is not free. In the case of misrepresentation, fraud, coercion, undue influence, the consent of one of the parties is induced or caused by the supposed existence of a fact which did not exist.

(ii) Mistake (Sections 20 and 21)

The law believes that contracts are made to be performed. The whole structure of business depends on this as the businessmen depend on the validity of contracts. Accordingly, the law says that it will not aid any one to evade consequences on the plea that he was mistaken.

On the other hand, the law also realises that mistakes do occur, and that these mistakes are so fundamental that there may be no contract at all. If the law recognises mistake in contract, the mistake will render the contract void.

Effect of Mistake

A mistake in the nature of miscalculation or error of judgement by one or both the parties has no effect on the validity of the contract. For example, if A pays an excessive price for goods under a mistake as to their true value, the contract is binding on him (*Leaf* v. *International Galleries* (1950) 1 All E.R. 693).

Therefore, mistake must be a “vital operative mistake”, i.e. it must be a mistake of fact which is fundamental to contract.

To be operative so as to render the contract void, the mistake must be:

(a) of fact, and not of law or opinion;

(b) the fact must be essential to agreement, i.e., so fundamental as to negative the agreement; and

(c) must be on the part of both the parties.

Thus, where both the parties to an agreement are under a mistake as to a matter of fact essential to agreement, the agreement is void (Section 20). Such a mistake prevents the formation of any contract at all and the Court will declare it void. For example, A agrees to buy from B a certain horse. It turns out that the horse was dead at the time of bargain though neither party was aware of the fact. The agreement is void.

Mistake of Law and Mistake of Fact

Mistakes are of two kinds: (i) mistake of law, and (ii) mistake of fact. If there is a mistake of law of the land, the contract is binding because everyone is deemed to have knowledge of law of the land and ignorance of law is no excuse *(ignorantia juris non-excusat).*

But mistake of foreign law and mistake of private rights are treated as mistakes of fact and are execusable.

The law of a foreign country is to be proved in Indian Courts as ordinary facts. So mistake of foreign law makes the contract void. Similarly, if a contract is made in ignorance of private right of a party, it would be void, e.g., where A buys property which already belongs to him.

Mutual or Unilateral Mistake

Mistake must be mutual or bilateral, i.e., it must be on the part of both parties. A unilateral mistake, i.e., mistake on the part of only one party, is generally of no effect unless (i) it concerns some fundamental fact and (ii) the other party is aware of the mistake. For this reason, error of judgement on the part of one of the parties has no effect and the contract will be valid.

Mutual or Common Mistake as to Subject-matter

A contract is void when the parties to it assume that a certain state of things exist which does not actually exist or in their ignorance the contract means one thing to one and another thing to the other, and they contract subject to that assumption or under that ignorance. There is a mistake on the part of both the parties. Such a mistake may relate to the existence of the subject matter, its identity, quantity or quality.

(a) *Mistake as to existence of the subject matter:* Where both parties believe the subject matter of the contract to be in existence but in fact, it is not in existence at the time of making the contract, there is mistake and the contract is void.

In *Couturier* v. *Hastie* (1857), there was a contact to buy cargo described as shipped from port A to port B and believed to be at sea which in fact got lost earlier unknown to the parties and hence not in existence at the time of the contract. Held, the contract was void due to the parties mistake.

(b) *Mistake as to identity of the subject matter:* Where the parties are not in agreement to the identity of the subject matter, i.e., one means one thing and

the other means another thing, the contract is void; there is no *consensus ad idem.*

In *Raffles* v. *Wichelhous* (1864), A agreed to buy from B a cargo of cotton to arrive "ex Peerless from Bombay". There were two ships called "Peerless" sailing from Bombay, one arriving in October and the other in December. A meant the earlier ship and B the latter. *Held,* the contract was void for mistake.

(c) *Mistake as to quantity of the subject matter:* There may be a mistake as to quantity or extent of the subject matter which will render the contract void even if the mistake was caused by the negligence of a third-party.

In *Henkel* v. *Pape* (1870), P wrote to H inquiring the price of rifles and suggested that he might buy as many as fifty. On receipt of a reply he wired send three rifles. Due to the mistake of the telegraph clerk the message transmitted to H was send the rifles. H despatched 50 rifles. *Held,* there was no contract between the parties.

(d) *Mistake as to quality of the subject-matter or promise:* Mistake as to quality raises difficult questions. If the mistake is on the part of both the parties the contract is void. But if the mistake is only on the part of one party difficulty arises.

The general rule is that a party to a contract does not owe any duty to the other party to discloses all the facts in his possession during negotiations. Even if he knows that the other party is ignorant of or under some misapprehension as to an important fact, he is under no obligation to enlighten him. Each party must protect his own interests unaided. In contract of sale of goods, this rule is summed up in the maxim *caveat emptor* (Let the buyer beware.) The seller is under no duty to reveal the defects of his goods to the buyer, subject to certain conditions.

Unilateral Mistake as to Nature of the Contract

The general rule is that a person who signs an instrument is bound by its terms even if he has not read it. But a person who signs a document under a fundamental mistake as to its nature (not merely as to its contents) may have it avoided provided the mistake was due to either-

(a) the blindness, illiteracy, or senility of the person signing, or

(b) a trick or fraudulent misrepresentation as to the nature of the document.

In *Foster* v. *Mackinnon* (1869), M, a senile man of feeble sight, endorsed a bill of exchange for £ 3,000 thinking it was a guarantee. *Held,* there was no contract and no liability was incurred by the signature. But if M knew that the document whereon he put his signature was a bill of exchange, he cannot avoid it on the ground that he believed that the bill was for £ 30 only. In the former case, he was mistaken as to the nature or character of the document. In the latter case he was mistaken as to the contents of the document.

Unilateral Mistake as to the Identity of the Person Contracted With

It is a rule of law that if a person intends to contract with A, B cannot give himself any right under it. Hence, when a contract is made in which personalities of the contracting parties are or may be of importance, no other person can interpose and

adopt the contract. For example, where M intends to contract only with A but enters into contract with B believing him to be A, the contract is vitiated by mistake as there is no *consensus ad idem.*

Mistake as to the identity of the person with whom the contract is made will operate to nullify the contract only if:

(i) the identity is for material importance to the contracts; and

(ii) the mistake is known to the other person, i.e., he knows that it is not intended that he should become a party to the contract.

In *Cundy* v. *Lindsay* [(1878) 3 A.C. 459, one Blenkarn posing as a reputed trader Blankiron, placed an order for some goods with M/s Lindsay and Co. The company, thought that it is dealing with Blankiron and supplied the goods. Blenkarn sold the goods to Cundy and did not pay to Lindsay. The latter sued Cundy. The Court held that there was no contract between Lindsay and Blenkarn and therefore Cundy has no title to the goods.

(iii) Misrepresentation (Section 18)

The term “misrepresentation” is ordinarily used to connote both “innocent misrepresentation” and “dishonest misrepresentation”. Misrepresentation may, therefore, be either (i) Innocent misrepresentation, or (ii) Wilful misrepresentation with *intent to deceive* and is called fraud.

Innocent Misrepresentation

If a person makes a representation believing what he says is true he commits innocent misrepresentation. Thus, any false representation, which is made with an honest belief in its truth is innocent. The effect of innocent misrepresentation is that the party misled by it can avoid the contract, but cannot sue for damages in the normal circumstances.

But in order to avoid a contract on the ground of misrepresentation, it is necessary to prove that:

(i) there was a representation or assertion,

(ii) such assertion induced the party aggrieved to enter into the contract.

(iii) the assertion related to a matter of fact (and not of law as ignorance of law is no excuse).

(iv) the statement was not a mere opinion or hearsay, or commendation (i.e., reasonable praise). For example an advertisement saying, “washes whiter than the whitest".

(v) the statement which has become or turned out to be untrue, was made with an honest belief in its truth.

Damages for Innocent Misrepresentation

Generally the injured party can only avoid the contract and cannot get damages for innocent misrepresentation. But in the following cases, damages are obtainable:

(i) From a promoter or director who makes innocent misrepresentation in a company prospectus inviting the public to subscribe for the shares in the company;

(ii) Against an agent who commits a breach of warranty of authority:

(iii) From a person who (at the Courts discretion) is estopped from denying a statement he has made where he made a positive statement intending that it should be relied upon and the innocent party did rely upon it and thereby suffered damages;

(iv) Negligent representation made by one person to another between whom a confidential relationship, like that of a solicitor and client exists.

(iv) Wilful Misrepresentation or Fraud (Section 17)

Fraud is an untrue statement made knowingly or without belief in its truth or recklessly, carelessly, whether it be true or false with the intent to deceive. The chief ingredients of a fraud are:

(i) a false representation or assertion;

(ii) of fact (and not a mere opinion),

(iii) made with the intention that it should be acted upon,

(iv) the representation must have actually induced the other party to enter into the contract and so deceived him,

(v) the party deceived must thereby be damnified, for there is no fraud without damages, and

(vi) the statement must have been made either with the knowledge that it was false or without belief in its truth or recklessly without caring whether it was true or false.

It is immaterial whether the representation takes effect by false statement or with concealment. The party defrauded can avoid the contract and also claim damages.

Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless silence is in itself equivalent to speech, or where it is the duty of the person keeping silent to speak as in the cases of contracts *uberrimae fidei* - (contracts requiring utmost good faith).

Contracts Uberrimae Fidei

There are contracts in which the law imposes a special duty to act with the utmost good faith i.e., to disclose all material information. Failure to disclose such information will render the contract voidable at the option of the other party.

Contracts *uberrimae fidei* are:

(a) *Contract of insurance of all kinds:* The assured must disclose to the insurer all material facts and whatever he states must be correct and truthful.

(b) *Company prospectus:* When a company invites the public to subscribe for its shares, it is under statutory obligation to disclose truthfully the various matters set out in the Companies Act. Any person responsible for non-disclosure of any of these matters is liable to damages. Also, the contract to buy shares is voidable where there is a material false statement or non-disclosure in the prospectus.

(c) *Contract for the sale of land:* The vendor is under a duty to the purchaser to show good title to the land he has contracted to sell.

(d) *Contracts of family arrangements:* When the members of a family make

agreements or arrangements for the settlement of family property, each member of the family must make full disclosure of every material fact within his knowledge.

Difference between Fraud and Innocent Misrepresentation

1. Fraud implies an intent to deceive, which is lacking if it is innocent misrepresentation.
2. In case of misrepresentation and fraudulent silence, the defendant can take a good plea that the plaintiff had the means of discovering the truth with ordinary diligence. This argument is not available if there is fraud (Section 19-exception).
3. In misrepresentation the plaintiff can avoid or rescind the contract. In fraud, the plaintiff can claim damages as well.
4. If there is fraud, it may lead to prosecution for an offence of cheating under the Indian Penal Code.

(v) Coercion

Coercion as defined in Section 15 means "the committing or threatening to commit any act forbidden by the Indian Penal Code, or unlawful detaining or threatening to detain, any property to the prejudice of any person whatever with the intention of causing any person to enter into an agreement". Simply stated, the doing of any act forbidden by the Indian Penal Code is coercion even though such an act is done in a place where the Indian Penal Code is not in force. If A at the point of a pistol asks B to execute a promissory note in his favour and B to save his life does so he can avoid this agreement as his consent was not free. Even a threat to third-party, e.g., where A compels B to sign a document threatening to harm C, in case B does not sign would also amount to coercion.

It has been held that mere threat by one person to another to prosecute him does not amount to coercion. There must be a contract made under the threat and that contract should be one sought to be avoided because of coercion (*Ramchandra* v. *Bank of Kohlapur,* 1952 Bom. 715). It may be pointed out that coercion may proceed from any person and may be directed against any person, even a stranger and also against goods, e.g., by unlawful detention of goods.

(vi) Undue Influence

Under Section 16 of the Indian Contract Act, 1872, a contract is said to be produced by undue influence "where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other".

The elements of undue influence are (i) a dominant position, and (ii) the use of it to obtain an unfair advantage. The words "unfair advantage" do not limit the jurisdiction to cases where the transaction would be obviously unfair as between persons dealing on an equal footing. In the words of Lord Kingston, "the principle applies to every case where influence is acquired and abused where confidence is reposed and betrayed".

Sub-section (2) of Section 16 provides that a person is deemed to be in a

position to dominate the will of another—

(a) Where he holds a real or apparent authority over the other or where he stands in a fiduciary relation to the other, e.g., minor and guardian; trustee and beneficiary; solicitor and client. There is, however, no presumption of undue influence in the relation of creditor and debtor, husband and wife (unless the wife is a *parda-nishin* woman) and landlord and tenant. In these cases the party has to prove that undue influence has been exercised on him, there being no presumption as to existence of undue influence.

(b) Where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily distress e.g., doctor and patient.

Illustration

A, having advanced money to his son B, during his minority, upon B's coming of age obtains, by misuse of parental influence a bond upon B for a greater amount than the sum due in respect of the advance. A employs undue influence.

A, a man enfeebled by disease or age is induced by B's influence over him as his medical attendant, to agree to pay B an unreasonable sum for his professional services. B employs undue influence.

A parent stands in a fiduciary relation towards his child and any transaction between them by which any benefit is procured by the parent to himself or to a third party, at the expense of the child will be viewed with jealousy by Courts of Equity and the burden will be on the parent or third-party claiming the benefit of showing that the child while entering into the transaction had independent advice, that he thoroughly understood the nature of transaction and that he was removed from all undue influence when the gift was made (*Marim Bibi* v. *Cassim Ebrahim* (1939) 184 I.C. 171 (1939) A.I.R. 278).

Where there is a presumption of undue influence, the presumption can be rebutted by showing that

(i) full disclosure of all material facts was made,

(ii) the consideration was adequate, and

(iii) the weaker party was in receipt of independent legal advice.

Transaction with parda-nishin women

The expression '*parda-nishin* denotes complete seclusion. Thus, a woman who goes to a Court and gives evidence, who fixes rents with tenants and collects rents, who communicates when necessary, in matters of business, with men other than members of her own family, could not be regarded as a parda-nishin woman (*Ismail Musafee* v. *Hafiz Boo* (1906) 33 Cal. LR 773 and 33 I.A. 86). The principles to be applied to transactions with parda-nishin woman are founded on *equity and good conscience* and accordingly a person who contracts with *parda-nishin* woman has to prove that no undue influence was used and that she had free and independent advice, fully understood the contents of the contract and exercised her free will. "The law throws around her a special cloak of protection" (*Kali Baksh* v. *Ram Gopal* (1914) L.R. 41 I.A. 23, 28-29, 36 All 81, 89).

Unconscionable transactions: An unconscionable transaction is one which makes

an exorbitant profit of the others distress by a person who is in a dominant position. Merely the fact that the rate of interest is very high in a money lending transaction shall not make it unconscionable. But if the rate of interest is very exorbitant and the Court regards the transaction unconscionable, the burden of proving that no undue influence was exercised lies on the creditor. It has been held that urgent need of money on the part of the borrower does not itself place the lender in a position to dominate his will within the meaning of this Section (Sunder *Koer* v. *Rai Sham Krishen* (1907) 34 Cal. 150, C.R. 34 I.A. 9).

(vii) Legality of Object

One of the requisites of a valid contract is that the object should be lawful. Section 10 of the Indian Contract Act, 1872, provides, "All agreements are contracts if they are made by free consent of parties competent to contract *for a lawful consideration and with a lawful object..."* Therefore, it follows that where the consideration or object for which an agreement is made is unlawful, it is not a contract.

Section 23 of the Indian Contract Act, 1872 provides that the consideration or object of an agreement is lawful unless it is

(i) forbidden by law; or
(ii) it is of such nature that if permitted it would defeat the provisions of law; or
(iii) is fraudulent; or
(iv) involves or implies injury to the person or property of another; or
(v) the Court regards it an immoral or opposed to public policy.

In each of these cases the consideration or object of an agreement is said to be unlawful. *Every agreement of which the object or consideration is unlawful is void.*

Illustration

(i) X, Y and Z enter into an agreement for the division among them of gains acquired by them by fraud. The agreement is void as its object is unlawful.
(ii) X promises to obtain for Y an employment in the Government service and Y promises to pay Rs. 1,500 to X. The agreement is void, as the consideration for it is unlawful.
(iii) X promises to Y to drop a prosecution which he has instituted against Y for robbery, and Y promises to restore the value of the things taken. The agreement is void as its object is unlawful.
(iv) A who is B's *mukhtr* promises to exercise his influence, as such, with B in favour of C and C promises to pay Rs. 1,000 to A. The agreement is void because it is immoral.
(v) A agrees to let her daughter to hire to B for concubinage. The agreement is void because it is immoral though, the letting may not be punishable under the India Penal Code.
(vi) An agreement by the proprietors of a newspaper to indemnify the printers against claims arising from libels printed in the newspaper is void as it implies or involves injury to the person of another.

Void and Illegal Contracts

A void contract is one which is destitue of legal effects altogether. An illegal contract too has no legal effect as between the immediate parties to the contract, but has the further effect of tainting the collateral contracts also with illegality. For instance A borrows from B to Rs. 1,000 for lending to C a minor. The contract between A and C is void, but B can nevertheless recover the money from A, On the other hand, if A had borrowed Rs. 1,000 from B to buy a pistol to shoot C, the question whether B can recover the money hinges on whether B was aware of the purpose for which money was borrowed. If B had knowledge of the illegal purpose, he cannot recover. Therefore, it may be said *that all illegal agreements are void but all void agreements are not necessarily illegal*.

Consequence of Illegal Agreements

(i) an illegal agreement is entirely void;

(ii) no action can be brought by a party to an illegal agreement. The maxim is *"Ex turpi cause non-oritur action"* - from an evil cause, no action arises;

(iii) money paid or property transferred under an illegal agreement cannot be recovered. The maxim is *in parti delicto potier est conditio defendeties* - In cases of equal guilt, more powerful is the condition of the defendant;

(iv) where an agreement consist of two parts, one part legal and other illegal, and the legal parts is separable from the illegal one, then the Court will enforce the legal one. If the legal and the illegal parts cannot be separated the whole agreement is illegal; and

(v) any agreement which is collateral to an illegal agreement is also tainted with illegality and is treated as being illegal, even though it would have been lawful by itself (*Film Pratapchand* v. *Firm Kotri* Re. AIR (1975) S.C. 1223).

Exception to General Rule of no Recovery of Money or Property

In the following cases, a party to an illegal agreement may sue to recover money paid or property transferred:

(a) Where the transfer is not in *pari delicto* (equally guilty) with the detendant, i.e. the transferee. For example, where A is induced to enter into an illegal agreement by the fraud of B, A may recover the money paid if he did not know that the contract was illegal.

(b) If the plaintiff can frame a cause of action entirely dependent of the contract.

(c) Where a substantial part of the illegal transaction has not been carried out and the plaintiff is truly and genuinely repentant. (*Bigos* v. *Bonstead* (1951), All E.R. 92).

Immoral Agreements

An agreement is illegal if its object is immoral or where its consideration is an act of sexual immorality, e.g., an agreement for future illicit co-habitation, the agreement is illegal and so unenforceable. Similarly, where the purpose of the agreement is the furtherance of sexual immorality and both the parties know this, it is illegal. Where A let a taxi on hire to B, a prostitute, knowing that it was to be used for immoral

purposes, it was held that A could not recover the hire charges. (*Pearce* v. *Brookes* (1866) L.R. 1 Exch 213).

Agreements Void as being Opposed to Public Policy

The head public policy covers a wide range of topics. Agreements may offend public policy by tending to the prejudice of the State in times of war, by tending to the abuse of justice or by trying to impose unreasonable and inconvenient restrictions on the free choice of individuals in marriage, or their liberty to exercise lawful trade or calling. The doctrine of public policy is a branch of Common Law and like any other branch of Common Law it is governed by the precedents [*Gherulal Parakh* v. *Mahadeodas Maiya* (1959) 2 S.C.R. (Suppl.) 406; AIR 1959 S.C. 781]. The doctrine of public policy is not to be extended beyond the classes of cases already covered by it and no Court can invent a new head of public policy [*Lord Halsbury, Janson* v. *Driefontien Consolidated Mines* (1902) A.C. 484, 491]. It has been said by the House of Lords that public policy is always an unsafe and treacherous ground for legal decisions. Even if it is possible for Courts to evolve a new head of public policy, it should be done under extraordinary circumstances giving rise to incontestable harm to the society.

The following agreement are void as being against public policy but they are not illegal:

(a) *Agreement in restrain of parental rights:* An agreement by which a party deprives himself of the custody of his child is void.

(b) *Agreement in restraint of marriage:* An agreement not to marry at all or not to marry any particular person or class of persons is void as it is in restraint of marriage.

(c) *Marriage brocage or brokerage Agreements:* An agreement to procure marriage for reward is void. Where a purohit (priest) was promised Rs. 200 in consideration of procuring a wife for the defendant, the promise was held void as opposed to public policy, and the purohit could not recover the promised sum.

(d) *Agreements in restraint of personal freedom are void:* Where a man agreed with his money lender not to change his residence, or his employment or to part with any of his property or to incur any obligation on credit without the consent of the money lender, it was held that the agreement was void.

(e) *Agreement in restraint of trade:* An agreement in restraint of trade is one which seeks to restrict a person from freely exercising his trade or profession.

AGREEMENTS IN RESTRAINT OF TRADE VOID

Section 27 of the Indian Contract Act states that every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is, to that extent, void.

This Section is not happily worded and has been criticised by many authors. It appears from the wording that every kind of restraint, whether total or partial falls within the prohibition of this Section. In English law the Courts have held that if a restraint is reasonable, it will be valid. Leading case on his point is *Nordenfelt* v. *Maxim Nordenfelt Guns Co.,* (1894) A.C. 535. N was an inventor and a manufacturer

of guns and ammunition. He sold his world-wide business to M and promised not to manufacture guns anywhere in the world for 25 years. The House of Lords held that the restraint was reasonable as it was no more than is necessary for the protection of the company, the contract was binding. Whether a restraint is reasonable or not depends upon the facts of each case.

Our courts are not consistent on the point whether reasonable restraints are permitted or not. In *Madhub Chunder* v. *RaCoomar* (1874) 14 Bang. L.R. 76, A paid Rs. 900 to B's workman. B undertook to stop his business in a particular locality in Calcutta. He did not keep his promise. A's suit for the sum was dismissed since the agreement was void under Section 27. The reasonableness or otherwise of the restraint was not discussed. However, if a restrictive meaning is adopted, most of the ordinary mercantile agreements may be hit. Thus, the Courts have held that if the restraint is one which is really necessary for the carrying on business, the same is not prohibited. In *Mackenzie* v. *Sitarmiah,* (1891) 15 Mad. 79, A agreed to sell to B all the salt he manufactured and B agreed to buy such salt. A further agreed not to sell salt to third-parties. The Court held that the agreement was valid.

Other type of restrains are personal covenants between an employer and his employee whereby the latter agrees not to compete with the former or serve with any of his competitors after employment. This issue came before the Supreme Court in *Niranjan Shanker Golikari* v. *The Century Spinning and Manufacturing Co. Ltd.,* AIR 1967 S.C. 1098. In this case N entered into a bond with the company to serve for a period of five years. In case, N leaves his job earlier and joins elsewhere with companys competitor within five years, he was liable for damages. N was imparted the necessary training but he left the job and joined another company. The former employer instituted a suit against N. The Supreme Court, held that the restraint was necessary for the protection of the companys interests and not such as the Court would refuse to enforce.

In other case, it has been reiterated that the restriction should be reasonable taking into account the facts and circumstances of the case. In *Superintendence Company of India Ltd*. v. *Krishna Murgai* [(1981) 2 SCC 246], the Supreme Court laid down that a restraint beyond the term of service would be void and the only ground on which it can be justified is by showing it is necessary for the protection of the employers goodwill.

The words "to the extent" in Section 27 make it clear that if in an agreement there are some convenants which are prohibited whereas the others are not and if the two parts can be separated then only those convenants which operate as restraint of trade would be void and not whole of the agreement itself. To illustrate, in *Brahmputra Tea Co. Ltd.* v. *Scarth* (1885) I.L.R. Cal. 545, the employee agreed with the employer firstly, not to compete with latter after leaving the job and, secondly, not to injure employer's interest during employment. The Court held that the first condition is a restraint of trade but the second is binding.

When Contracts in Restraint of Trade Valid

Prima facie every restraint of trade is void , but certain exceptions to this general rule are recognised. If a partial and reasonable restraint falls under any of the following exceptions, the contract will be enforceable:

(a) *Sale of goodwill:* Where the seller of the goodwill of a business undertakes

not to compete with the purchaser of the goodwill, the contract is enforceable provided the restraint appears to be reasonable as to territorial limits and the length of time.

(b) *Partners agreements:* Section 11(2) of the Indian Partnership Act permits contracts between partners to provide that a partner shall not carry on any business other than that of the firm while he is a partner.

(c) Section 36(2) and Section 54 of the Indian Partnership Act provide that a partner may make an agreement with his partners that on ceasing to be a partner he will not carry on any business similar to that of the firm within specified period or within specified limits. The agreement shall be binding if the restrictions are reasonable.

Trade Combinations: An agreement, the object of which is to regulate business and not to restrain it is valid. Thus, an agreement in the nature of a business combination between traders or manufactures e.g. not to sell their goods below a certain price, to pool profits or output and to divide the same in an agreed proportion does not amount to a restraint of trade and is perfectly valid (*Fraster & Co.* v. *Laxmi Narain,* (1931) 63 All 316).

Negative stipulations in service agreements: An agreement of service by which a person binds himself during the term of the agreement not to take service with anyone else is not in restraint of lawful profession and is valid.

WAGERING AGREEMENTS

The literal meaning of the word “wager” is a “bet”. Wagerning agreements are nothing but ordinary betting agreements. For example, A and B enter into an agreement that if Englands Cricket Team wins the test match, A will pay B Rs. 100 and if it loses B will pay Rs. 100 to A. This is a wagering agreement and nothing can be recovered by winning party under the agreement.

The essence of gaming and wagering is that one party is to win and the other to lose upon a future event which at the time of the contract is of an uncertain nature that is to say, if the event turns out one way A will lose; but if it turns out the other way he will win (*Thacker* v. *Hardy, (*1878) 4 OBD 685).

Wagering Agreements Void

In India except Mumbai, wagering agreements are void. In Mumbai, wagering agreements have been declared illegal by the Avoiding Wagers (Amendment) Act, 1865. Therefore, in Mumbai a wagering agreement being illegal, is void not only between the immediate parties, but taints and renders void all collateral agreements to it.

Thus, A bets with B and losses, applies to C for a loan, who pays B in settlement of A’s losses. C cannot recover from A because this is money paid “under” or “in respect of” a wagering transaction which is illegal in Mumbai. But in respect of India such a transaction (i.e., betting) being only void, C could recover from A. Of course, if A refused to pay B the amount of the bet that he has lost, B could not sue A anywhere. Again, where an agent bets on behalf of his principal and looses and pays

over the money to the winner, he cannot recover the money from his principal, if the transactions took place in Mumbai, but elsewhere he could recover. But if the agent wins, he must pay the winnings to the principal, as this money was received on behalf of the principal.

Sometimes, commercial transactions assume the form of wagering contracts. The sample test to find out whether a particular transaction is a wager or a genuine commercial transaction is: "Where delivery of the goods sold is intended to be given and taken, it is valid contract, but where only the differences are intended to be paid, it will be a wagering contract and unenforceable".

In a wagering contract there must be mutuality in the sense that the gain of one party should be loss to the other on the happening of an uncertain event which is the subject matter of the contract.

VOID AGREEMENTS

The following types of agreements are void under Indian Contract Act:

(a) Agreement by or with a minor or a person of unsound mind or a person disqualified to enter into a contract - Section 11;
(b) Agreement made under a mistake of fact, material to the agreement on the part of the both the parties - Section 20.
(c) An agreement of which the consideration or object is unlawful - Section 23.
(d) If any part of a single consideration for one or more objects, or any one or any part of any one of several considerations for a single object, is unlawful, the agreement is void - Section 24.
(e) An agreement made without consideration subject to three exceptions provided to Section 25.
(f) An agreement in restraint of marriage - Section 26.
(g) An agreement in restraint of trade - Section 27.
(h) An agreement in restraint of legal proceedings - Section 28.
(i) Agreements, the meaning of which is not certain, or capable of being made certain - Section 29.
(j) Agreement by way of wager- Section 30.
(k) An agreement to enter into an agreement in the future.
(l) An agreement to do an act impossible in itself - Section 56(1)

When contract becomes void

An agreement not enforceable by law is void *ab initio* - Section 2(g).

A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable - Section 2(j)

A contract becomes void when, by reason of some event which the promisor could not prevent, the performance of the contract becomes impossible, e.g., by destruction of the subject- matter of the contract after the formation of the contract.

A contract becomes void by reason of subsequent illegality. A in India agrees to supply goods to B in Pakistan. After the formation of the contract war breaks out between India and Pakistan and the supply of goods to Pakistan is prohibited by

legislation. The contract becomes void.

A contingent contract to do or not do to anything if an uncertain future event happens becomes void if the event becomes impossible.

Where a contract is voidable at the option of the aggrieved party, the contract becomes void when the option is exercised by him.

RESTITUTION

When a contract becomes void, it is not to be performed by either party. But if any party has received any benefit under such a contract from the other party he must restore it or make compensation for it to the other party. A agrees to sell to B after 6 months a certain quantity of gold and receives Rs 500 as advance. Soon after the agreement, private sales of gold are prohibited by law. The contract becomes void and A must return the sum of Rs. 500 to B.

Restitution is also provided for by Section 65 where an agreement is discovered to be void. A pays Rs. 500 in consideration of B's promising to marry, C, A's daughter C is dead at the time of the promise. The agreement is discovered to be void and B must pay back Rs. 500.

But there is no resolution where the parties are wholly incompetent to contract, e.g., where one of the parties is a minor. The minor cannot be asked to restore the benefit, e.g., a minor borrowed Rs. 1,000 from B, he cannot be asked to pay back Rs. 1,000 to B because the contract is void (*Mohiri Bibis* case).

CONTINGENT CONTRACT (Section 31)

As per Section 31, a contingent contract is a contract to do or not to do something, if some event *collateral to such contract,* does or does not happen. For example, A contracts to sell B 10 bales of cotton for Rs. 20,000, if the ship by which they are coming returns safely. This is a contingent contract.

Contract of insurance and contracts of indemnity and guarantee are popular instances of contingent contracts.

Rules regarding contingent contracts

The following rules are contained in Section 32-36:

(a) Contracts contingent upon the happening of a future uncertain event cannot be enforced by law unless and until that event has happened. If the event becomes impossible, the contract becomes void - Section 32.

  (i) A makes a contract to buy B's house if A survives C. This contract cannot be enforced by law unless and until C dies in A's lifetime.

  (ii) A contracts to pay B a sum of money when B marries C, C dies without being married to B. The contract becomes void.

(b) Contracts contingent upon the non-happening of an uncertain future event can be enforced when the happening of that event becomes impossible and not before - Section 33.

  A contracts to pay B a certain sum of money if a certain ship does not return. The ship is sunk. The contract can be enforced when the ship sinks.

(c) If a contract is contingent upon how a person will act at an unspecified time,

the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time or otherwise than under further contingencies - Section 34.

A agrees to pay B Rs. 1,000 if B marries C. C marries D. The marriage of B to C must now be considered impossible although it is possible that D may die and C may afterwards marry B.

(d) Contracts contingent on the happening of an event within a fixed time become void if, at the expiration of the time, such event has not happened, or if, before the time fixed, such event becomes impossible - Section 35.

A promises to pay B a sum of money if a certain ship returns with in a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.

(e) Contracts contingent upon the non-happening of an event within a fixed time may be enforced by law when the time fixed has expired and such event has not happened or before the time fixed has expired, if it becomes certain that such event will not happen - Section 35

A promises to pay B a sum of money if a certain ship does not return within the year. The contract may be enforced if the ship does not return within the year or is burnt within the year.

(f) Contingent agreements to do or not to do anything if an impossible event happens, are void, whether the impossibility of the event is known or not known to the parties to the agreement at the time when it is made - Section 36.

A agrees to pay Rs. 1,000 to B if two straight lines should enclose a space. The agreement is void.

CERTAIN RELATIONS RESEMBLING THOSE OF CONTRACT (QUASI CONTRACTS)

Nature of Quasi-Contracts

A valid contract must contain certain essential elements, such as offer and acceptance, capacity to contract, consideration and free consent. But sometimes the law implies a promise imposing obligations on one party and conferring right in favour of the other even when there is no offer, no acceptance, no *consensus ad idem,* and in fact, there is neither agreement nor promise. Such cases are not contracts in the strict sense, but the Court recognises them as relations resembling those of contracts and enforces them as if they were contracts, hence the term quasi- contracts (i.e., resembling a contract).

A quasi-contract rests on the equitable principle that a person shall not be allowed to enrich himself unjustly at the expense of another. In truth, it is not a contract at all. It is an obligation which the law creates, in the absence of any agreement, when any person is in the possession of one persons money, or its equivalent, under such circumstances that in equity and good conscience he ought not to retain it, and which in justice and fairness belongs to another. It is the duty and not an agreement or intention which defines it. A very simple illustration is money paid under mistake. Equity demands that such money must be paid back.

Quasi-Contracts or Implied Contracts under the Indian Contract Act

The following types of quasi-contracts have been dealt within the Indian Contract Act—

(a) Necessaries supplied to person incapable of contracting or to anyone whom he is illegally bound to support - Section 68.
(b) Suit for money had and received - Section 69 and 72.
(c) *Quantum Meruit*
(d) Obligations of a finder of goods - Section 71.
(e) Obligation of person enjoying benefit of a non-gratuitous act - Section 70

Necessaries

Contracts by minors and persons of unsound mind are void. However, Section 68 of the Indian Contract Act provides that their estates are liable to reimburse the trader, who supplies them with necessaries of life.

Suit for money had and received

The right to file a suit for the recovery of money may arise

(a) *Where the plaintiff paid money to the defendant* (i) under a mistake, (ii) in pursuance of a contract the consideration for which has failed, or (iii) under coercion, oppression, extortion or other such means.

A debtor may recover, from a creditor the amount of an over-payment made to him by mistake. The mistake may be mistake of fact or a mistake of law.

(b) *Payment to third-party of money which another is bound to pay.* For example, where A's goods are wrongfully attached in order to realise arrears of Government revenue due by B, and A pays the amount to save his goods from being sold, he is entitled to recover the amount from B.

(c) *Money obtained by defendant from third-parties.* For example, where an agent has obtained a secret commission or a fraudulent payment from a third-party, the principle can recover the amount from the agent.

Quantum Meruit

The expression *"Quantum Meruit"* literally means "as much as earned" or reasonable remuneration. It is used where a person claims reasonable remuneration for the services rendered by him when there was no express promise to pay the definite remuneration, Thus, the law implies reasonable compensation for the services rendered by a party if there are circumstances showing that these are to be paid for.

The general rule is that where a party to a contract has not fully performed what the contract demands as a condition of payment, he cannot sue for payment for that which he has done. The contract has to be indivisible and the payment can be demanded only on the completion of the contract.

But where one party who has performed part of his contract is prevented by the other from completing it, he may sue on a *quantum meruit*, for the value of what he has done.

The claim on a *quantum meruit* arises when one party abandons the contract, or

accepts the work done by another under a void contract.

The party in default may also sue on a *"quantum meruit"* for what he has done if the contract is divisible and the other party has had the benefit of the part which has been performed. But if the contract is not divisible, the party at fault cannot claim the value of what he has done.

Obligations of finder of lost goods

The liability of a finder of goods belonging to someone else is that of a bailee. This means that he must take as much care of the goods as a man of ordinary prudence would take of his own goods of the same kind. So far as the real owner of the goods is concerned, the finder is only a bailee and must not appropriate the goods to his own use. If the owner is traced, he must return the goods to him. The finder is entitled to get the reward that may have been offered by the owner and also any expenses he may have incurred in protecting and preserving the property.

Obligation of a person enjoying benefit of non-gratuitous act

Section 70 of the Indian Contract Act provides that where a person lawfully does something for another person or delivers anything to him without any intention of doing so gratuitously and the other person accepts and enjoys the benefit thereof, the latter must compensate the former or restore to him the thing so delivered. For example, when one of the two joint tenants pays the whole rent to the landlord, he is entitled to compensation from his co-tenant, or if A, a tradesmen, leaves goods at B's house by mistake and B treats the goods as his own, he is bound to pay A for them.

DISCHARGE OR TERMINATION OF CONTRACTS

A contract is said to be discharged or terminated when the rights and obligations arising out of a contract are extinguished.

Contracts may be discharged or terminated by any of the following modes:

(a) performance, i.e., by fulfilment of the duties undertaken by parties or, by tender;

(b) mutual consent or agreement.

(c) lapse of time;

(d) operation of law;

(e) impossibility of performance; and

(f) breach of contract.

(a) Performance of Contracts (Section 37)

Section 37 of the Act provides that the parties to a contract must either perform or offer to perform their respective promises, unless such performance is dispensed with or excused under the provision of the Indian Contract Act, or any other law. In case of death of the promisor before performance, the representatives of the promisor are bound to perform the promise *unless a contrary intention appears from the contract.*

Illustration

X promises to deliver a horse to Y on a certain day on payment of Rs 1,000. X

dies before that day. X's representatives are bound to deliver the horse to Y and Y is bound is pay Rs. 1,000 to X's representatives.

Tender of Performance (Section 38)

In case of some contracts, it is sometimes sufficient if the promisor performs his side of the contract. Then, if the performance is rejected,the promisor is discharged from further liability and may sue for the breach of contract if he so wishes. This is called discharge by tender.

To be valid, a tender must fulfil the following conditions

(a) it must be unconditional;

(b) if must be made at a proper time and place;

(c) it must be made under circumstances enabling the other party to ascertain that the party by whom it is made is able and willing then and there to do the whole of what he is bound, to do by his promise;

(d) if the tender relates to delivery of goods, the promisee must have a reasonable opportunity of seeing that the thing offered is the thing which the promisor is bound by his promise to deliver;

(e) tender made to one of the several joint promisees has the same effect as a tender to all of them.

Who can demand performance?

Generally speaking, a stranger to contract cannot sue and the person who can demand performance is the party to whom the promise is made. But an assignee of the rights and benefits under a contract may demand performance by the promisor, in the same way as the assignor, (i.e., the promisee) could have demanded.

Effect of refusal of party to perform wholly

Section 39 provides that when a party to a contract has refused to perform or disabled himself from performing his promise in its entirety, the promisee may put an end to the contract unless he had signified by words or conduct his acquiescence in its continuance.

Illustration

(a) X, a singer enters into a contract with Y, the manager of a theatre to sing at his theatres two nights in every week during the next two months, and Y engaged to pay her Rs. 100 for each nights performance. On the sixth night X wilfully absents herself form the theatre. Y is at liberty to put an end to the contract.

(b) If in the above illustration, with the assent of Y, X sings on the seventh night, Y is presumed to have signified his acquiescence in the continuance of the contract and cannot put an end to it; but is entitled to compensation for the damages sustained by him through X's failure to sing on the sixth night.

By whom contract must be performed

Under Section 40 of the Act, if it appears from the nature of the case that it was the intention of the parties to a contract that it should be performed by the promisor himself such promise must be performed by the promisor himself. In other cases, the promisor or his representative may employ a competent person to perform it.

Illustration

(a) X promises to pay Rs. 1,000 to Y. X may either personally pay the money to Y or cause it to be paid to Y by another. If X dies before making payment, his representatives must perform the promise or employ some proper person to do so.

(b) X promises to paint a picture for Y. X must personally perform the promise.

Devolution of Joint Liabilities

Under Section 42 of the Indian Contract Act, where two or more persons have made a joint promise then, *unless a contrary intention appears* from the contract all such persons should perform the promise. If any one of them dies, his representatives jointly with the survivor or survivors should perform. After the death of the last survivor, the representatives of all jointly must fulfil the promise.

Under Section 43 of the Indian Contract Act when two or more persons made a joint promise, the promisee may, in the *absence of an express agreement* to the contrary compel any one or more of such joint promisors to perform the whole of the promise. Each of two or more joint promisors may compel every other joint promisor to contribute equally with himself to the performance of the promise *unless a contrary intention appears from the contract.* If any one of two ore more promisors make default in such contribution, the remaining joint promisors should bear the loss arising from such default in equal share.

Illustrations

(a) X, Y and Z jointly promise to pay Rs. 6,000 to A. A may compel either X or Y or Z to pay the amount.

(b) In the above example imagine, Z is compelled to pay the whole amount; X is insolvent but his assets are sufficient to pay one-half of his debts. Z is entitled to receive Rs. 1,000 from X's estate and Rs. 2,500 from Y.

(c) X, Y and Z make a joint promise to pay Rs. 5,000 to A, Z is unable to pay any amount and X is compelled to pay the whole. X is entitled to receive Rs. 3,000 from Y.

Under Section 44 of the Act, where two or more persons have made a joint promise, a release of one of such joint promisors by the promisee does not discharge the other joint promisor(s); neither does it free the joint promisor so released from responsibility to the other joint promisor or joint promisors.

Devolution of Joint Rights

A promise may be made to two or more persons. The promisees are called joint promisees. For example, X may give a promise to repay Rs. 1,000 given by Y and Z jointly. In such case, *in the absence of a contrary intention*, the right to claim, performance rests with Y and Z. If Y dies, Y's representative jointly with Z may, demand performance. If Z also dies, the representatives of Y and Z may demand jointly performance from X.

Assignment

The promisee may assign rights and benefits of contract and the assignee will be entitled to demand performance by the promisor. But the assignment to be complete

and effectual, must be made by an instrument in writing.

An obligation or liability under a contract cannot be assigned. For example, if A owes B Rs. 500 and A transfers the liability to C i.e. asks C to pay the sum to B, this would not bind B, and B may not consent to this arrangement, as he may know nothing of C's solvency. But if B consents to accept performance by C, there is a substitution of new contract and the old contract is discharged and all rights and liabilities under it are extinguished. This is technically called *novation.*

(b) Discharge by Mutual Agreement or Consent (Sections 62 and 63)

A contract may be discharged by the agreement of all parties to the contract, or by waiver or release by the party entitled to performance.

The methods stipulated under Sections 62 and 63 of the Indian Contract Act for discharging a contract by mutual consent are:

Novation — when a new contract is substituted for existing contract either between the same parties or between different parties, the consideration mutually being the discharge of the old contract.

Alteration — change in one or more of the material terms of a contract.

Rescission — by agreement between the parties at any time before it is discharged by performance or in some other way.

Remission — acceptance of a lesser sum than what was contracted for or a lesser fulfilment of the promise made.

Waiver — deliberate abandonment or giving up of a right which a party is entitled to under a contract, where upon the other party to the contract is released from his obligation.

(c) Discharge by Lapes of Time

The Limitation Act, in certain circumstance, affords a good defence to suits for breach of contract, and infact terminates the contract by depriving the party of his remedy to law. For example, where a debtor has failed to repay the loan on the stipulated date, the creditor must file the suit against him within three years of the default. If the limitation period of three years expires and he takes no action he will be barred from his remedy and the other party is discharged of his liability to perform.

(d) Discharge by Operation of the Law

Discharge under this head may take place as follows:

(a) *By merger:* When the parties embody the inferior contract in a superior contract.

(b) *By the unauthorised alteration of items of a written document:* Where a party to a written contract makes any material alteration without knowledge and consent of the other, the contract can be avoided by the other party.

(c) *By insolvency:* The Insolvency Act provides for discharge of contracts under particular circumstances. For example, where the Court passes an order discharging the insolvent, this order exonerates or discharges him from

liabilities on all debts incurred previous to his adjudication.

(e) Discharge by Impossibility or Frustration (Section 56)

A contract which is entered into to perform something that is clearly impossible is void. For instance, A agrees with B to discover treasure by magic. The agreement is void by virtue of Section 56 para 1 which lays down the principle that an agreement to do an act impossible in itself is void.

Sometimes subsequent impossibility (i.e. where the impossibility supervenes after the contract has been made) renders the performance of a contract unlawful and stands discharged; as for example, where a singer contracts to sing and becomes too ill to do so, the contract becomes void. In this connection, para 2 of Section 56 provides that a contract to do an act, which after the contract is made, becomes impossible or by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.

If the impossibility is not obvious and the promisor alone knows of the impossibility or illegally then existing or the promisor might have known as such after using reasonable diligence, such promisor is bound to compensate the promisee for any loss he may suffer through the non-performance of the promise inspite of the agreement being void *ab-initio* (Section 56, para 3).

In *Satyabarta Ghose* v. *Mugnuram* A.I.R. 1954 S.C. 44 the Supreme Court interpreted the term 'impossible appearing in second paragraph of Section 56. The Court observed that the word 'impossible has not been used here in the sense of physical or literal impossibility. The performance of an act may not be literally impossible but it may be impracticable and useless from the point of view of the object and purpose which the parties had in view; and if an untoward event or change of circumstances totally upsets the very foundation upon which the parties rested their bargain; it can very well be said that the promisor found it impossible to do the act which he promised to do. In this case, A undertook to sell a plot of land to B but before the plot could be developed, war broke out and the land was temporarily requisitioned by the Government. A offered to return earnest money to B in cancellation of contract. B did not accept and sued A for specific performance. A pleaded discharge by frustration. The Court held that Section 56 is not applicable on the ground that the requisition was of temporary nature and there was no time limit within which A was obliged to perform the contract. The impossibility was not of such a nature which would strike at the root of the contract.

Discharge by Supervening Impossibility

A contract will be discharged by subsequent or supervening impossibility in any of the following ways:

(a) Where the subject-matter of the contract is destroyed without the fault of the parties, the contract is discharged.

(b) When a contract is entered into on the basis of the continued existence of a certain state of affairs, the contract is discharged if the state of things changes or ceases to exist.

(c) Where the personal qualifications of a party is the basis of the contract, the contract is discharged by the death or physical disablement of that party.

Discharge by Supervening Illegality

A contract which is contrary to law at the time of its formation is void. But if, after the making of the contract, owing to alteration of the law or the act of some person armed with statutory authority the performance of the contract becomes impossible, the contract is discharged. This is so because the performance of the promise is prevented or prohibited by a subsequent change in the law. A enters into contract with B for cutting trees. By a statutory provision cutting of trees is prohibited except under a licence and the same is refused to A. The contract is discharged.

Cases in which there is no supervening impossibility

In the following cases contracts are not discharged on the ground of supervening impossibility—

(a) *Difficulty of performance:* The mere fact that performance is more difficult or expensive than the parties anticipated does not discharge the duty to perform.

(b) *Commercial impossibilities* do not discharge the contract. A contract is not discharged merely because expectation of higher profits is not realised.

(c) Strikes, lockouts and civil disturbance like riots do not terminate contracts unless there is a clause in the contract providing for non-performance in such cases.

Supervening impossibility or illegality is known as frustration under English Law.

(f) Discharge by Breach

Where the promisor neither performs his contract nor does he tender performance, or where the performance is defective, there is a breach of contract. The breach of contract may be (i) actual; or (ii) anticipatory. The actual breach may take place either at the time the performance is due, or when actually performing the contract. Anticipatory breach means a breach before the time for the performance has arrived. This may also take place in two ways – by the promisor doing an act which makes the performance of his promise impossible or by the promisor in some other way showing his intention not to perform it.

Anticipatory Breach of Contract

Breach of contract may occur, before the time for performance is due. This may happen where one of the parties definitely renounces the contract and shows his intention not to perform it or does some act which makes performance impossible. The other party, on such a breach being committed, has a right of action for damages.

He may either sue for breach of contract immediately after repudiation or wait till the actual date when performance is due and then sue for breach. If the promisee adopts the latter course, i.e., waits till the date when performance is due, he keeps the contract alive for the benefit of the promisor as well as for his own. He remains liable under it and enables the promisor not only to complete the contract in spite of previous repudiation, but also to avail himself of any excuse for non- performance

which may have come into existence before the time fixed for performance.

In *Hochester* v. *De La Tour* (1853) E.R. 922, A hired B in April to act as a courier commencing employment from 1st June, but wrote to B in May repudiating the agreement, B sued A for breach of contract immediately after repudiation. A contended that there could not be breach of contract before June 1. *Held,* B was immediately entitled to sue and need not wait till 1st June, for his right of action to accrue.

In *Avery* v. *Bowden* (1856) 116 E.R. 1122, A hired B's ship to carry a cargo from Russia. Later on B repudiated the contract. A delayed taking action hoping B would change his mind before the performance date. War broke out between Russia and Britain before the performance date frustating the contract. *Held,* A lost his right to sue B for damages by his delay.

In *Frost* v. *Knight* (1872) L.R. 7 Ex. 111, the law on the subject of anticipatory breach was summed up as follows:

"The promisee if he pleases may treat the notice of intention as inoperative and await the time when the contract is to be executed and then hold the other party responsible for all the consequences of non-performance: but in that case he keeps the contract alive for the benefit of the other party as well as his own; he remains subject to all his own obligations and liabilities under it, and enables the other party not only to complete the contract, if so advised, notwithstanding his previous repudiation of it, but also to take advantage of any supervening circumstances which would justify him in declining to complete it. "

REMEDIES FOR BREACH

Where a contract is broken, the injured party has several courses of action open to him. The appropriate remedy in any case will depend upon the subject-matter of the contract and the nature of the breach.

(i) Remedies for Breach of Contract

In case of breach of contract, the injured party may:

(a) Rescind the contract and refuse further performance of the contract;
(b) Sue for damages;
(c) Sue for specific performance;
(d) Sue for an injunction to restrain the breach of a negative term; and
(e) Sue on *quantum meruit*

When a party to a contract has broken the contract, the other party may treat the contract as rescinded and he is absolved from all his obligations under the contract. Under Section 65, when a party treats the contract as rescinded, he makes himself liable to restore any benefits he has received under the contract to the party from whom such benefits were received. Under Section 75 of the Indian Contract Act, if a person rightfully rescinds a contract, he is entitled to a compensation for any damage which he has sustained through the non-fulfilment of the contract by the other party. Section 64 deals with consequences of rescission of voidable contracts, i.e., where there is flaw in the consent of one party to the contract. Under this Section when a person at whose option a contract is voidable rescinds, the other party thereto need

not perform any promise therein contained in which he is the promisor. The party rescinding a voidable contract shall, if he has received any benefit thereunder, from another party to such contract, restore such benefit so far as may be, to the person from whom it was received.

(ii) Damages for Breach of Contract

Under Section 73 of the Indian Contract Act, when a contract has been broken, a party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage, caused to him thereby, *which naturally arose in the usual course of things from such breach or which the parties knew, when they made the contract to be likely to result from the breach of it.* Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach.

The foundation of the claim for damages rests in the celebrated case of *Hadley* v. *Baxendale*, (1854) 9 Ex. 341. The facts of this case were as follows:

There was a breakdown of a shaft in A's mill. He delivered the shaft to B, a common carrier to be taken to a manufacturer to copy and make a new one. A did not make known to B that delay would result in loss of profits. By some neglect on the part of B, the *delivery of the shaft was delayed in transit beyond a reasonable time.* As a result, the mill was idle for a longer period than it would otherwise have been, had there been no such delay. It was held, B was not liable for the loss of profits during the period of delay as the circumstances communicated to A did not show that the delay in the delivery of the shaft would entail loss of profits to the mill. In the course of the judgement it was observed:

"Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants and thus known to both the parties, the damages resulting from the breach of such a contract which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on other hand, if these special circumstances were wholly unknown to the party breaking the contract, he at the most could only be supposed to have had in his contemplation, the amount of injury which would arise generally and in the great multitude of cases not affected by any special circumstances from such breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to damages in that case and of this advantage it would be very unjust to deprive them."

Liquidated and *Unliquidated* damages: Where the contracting parties agree in advance the amount payable in the event of breach, the sum payable is called *liquidated damages.*

Where the amount of compensation claimed for a breach of contract is left to be assessed by the Court, damages claimed are called *unliquidated damages.*

Unliquidated Damages

Those are of the following kinds:

(a) general or ordinary damages, (b) special damages (c) exemplary or punitive damages, and (d) nominal damages.

Ordinary Damages

These are restricted to pecuniary compensation to put the injured party in the position he would have been had the contract been performed. It is the estimated amount of loss actually incurred. Thus, it applies only to the proximate consequences of the breach of the contract and the remote consequences are not generally regarded. For example, in a contract for the sale of goods, the damages payable would be the difference between the contract price and the price at which the goods are available on the date of the breach.

Special Damages

Special damages are those resulting from a breach of contract under some peculiar circumstances. If at the time of entering into the contract, the party has notice of special circumstances which makes special loss the likely result of the breach in the ordinary course of things, then upon his-breaking the contract and the special loss following this breach, he will be required to make good the special loss. For example, A delivered goods to the Railway Administration to be carried to a place where an exhibition was being held and told the goods clerk that if the goods did not reach the destination on the stipulated date he would suffer a special loss. The goods reached late. He was entitled to claim special damages.

Exemplary Damages

These damages are awarded to punish the defendant and are not, as a rule, granted in case of breach of contract. In two cases, however, the court may award such damages, viz.,

(i) breach of promise to marry; and

(ii) wrongful dishonour of a customers cheque by the banker.

In a breach of promise to marry, the amount of the damages will depend upon the extent of injury to the partys feelings. In the bankers case, the smaller the amount of the cheque dishonoured, larger will be damages as the credit of the customer would be injured in a far greater measure, if a cheque for a small amount is wrongfully dishonoured.

Nominal Damages

Nominal damages consist of a small token award, e.g., a rupee of even 25 paise, where there has been an infringement of contractual rights, but no actual loss has been suffered. These damages are awarded to establish the right to decree for breach of contract.

Liquidated Damages and Penalty

Where the contracting parties fix at the time of contract the amount of damages that would be payable in case of breach, in English law, the question may arise whether the term amounts to “liquidated damages” or a “penalty”? The Courts in England usually give effect to liquidated damages, but they always relieve against

penalty.

The test of the two is that where the amount fixed is a genuine pre-estimate of the loss in case of breach, it is liquidated damages and will be allowed. If the amount fixed is without any regard to probable loss, but is intended to frighten the party and to prevent him from committing breach, it is a penalty and will not be allowed.

In Indian law, there is no such difference between liquidated damages and penalty. Section 74 provides for "reasonable compensation" upto the stipulated amount whether it is by way of liquidated damages or penalty. For example, A borrows
Rs. 500 from B and promises to pay Rs. 1,000 if he fails to repay Rs. 500 on the stipulated date. On A's failure to repay on the given date, B is entitled to recover from A such compensation, not exceeding Rs. 1,000 as the Court may consider reasonable. (*Union of India* v. *Raman Iron Foundry,* AIR 1974 SC 1265).

(iii) Specific Performance

It means the actual carrying out by the parties of their contract, and in proper cases the Court will insist upon the parties carrying out this agreement. Where a party fails to perform the contract, the Court may, at its discretion, order the defendant to carry out his undertaking according to the terms of the contract. A decree for specific performance may be granted in addition to or instead of damages.

Specific performance is usually granted in contracts connected with land, e.g., purchase of a particular plot or house, or to take debentures in a company. In case of sale of goods, it will only be granted if the goods are unique and cannot be purchased in the market, e.g., a particular race horse, or one of special value to the party suing by reason of personal or family association, e.g., an heirloom.

Specific performance will not be ordered:

(a) where monetary compensation is an adequate remedy;
(b) where the Court cannot supervise the execution of the contract, e.g., a building contract;
(c) where the contract is for personal service; and
(d) where one of the parties is a minor.

(iv) Injunction

An injunction, is an order of a Court restraining a person from doing a particular act. It is a mode of securing the specific performance of a negative term of the contract, (i.e., where he is doing something which he promises not to do), the Court may in its discretion issue an order to the defendant restraining him from doing what he promised not to do. Injunction may be prohibitory or mandatory. In prohibitory, the Court restrains the commission of a wrongful act whereas in mandatory, it restrains continuance of a wrongful commission.

In *Lumley* v. *Wagner* (1852) 90 R.R. 125. W agreed to sing at L's theatre and nowhere else. W, in breach of contract with L entered into a contract to sing for Z. *Held,* although W could not be compelled to sing at Ls theatre, yet she could be restrained by injunction from singing for Z.

CONTRACT OF INDEMNITY AND GUARANTEE (Sections 124 to 147)

Meaning of Indemnity

A contract of indemnity is a contract by which one party promises to save the other party from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person (Section 124). For example, A contracts to indemnify B against the consequence of any proceedings which C may take against B in respect of a certain sum of 300 rupees. This is a contract of indemnity. The contract of indemnity may be express or implied. The later may be inferred from the circumstances of a particular case, e.g., an act done by A at the request of B. If A incurs any expenses, he can recover the same from B.

The person who promises to indemnify or make good the loss is called the indemnifier and the person whose loss is made good is called the indemnified or the indemnity holder. A contract of insurance is an example of a contract of indemnity according to English Law. In consideration of premium, the insurer promises to make good the loss suffered by the assured on account of the destruction by fire of his property insured against fire.

Under the Indian Contract Act, the contract of indemnity is restricted to such cases only where the loss promised to be reimbursed, is caused by the conduct of the promisor or of any other person. The loss caused by events or accidents which do not depend on the conduct of any person, it seems, cannot be sought to be reimbursed under a contract of indemnity.

Rights of Indemnity Holder when Sued

Under Section 125, the promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor—

(1) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;

(2) all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as if it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit; and

(3) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit.

Meaning of Contract of Guarantee

A contract of guarantee is a contract to perform the promise, or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the Surety, the person for whom the guarantee is given is called the Principal Debtor, and the person to whom the guarantee is given is called the Creditor (Section 126). A guarantee may be either oral or written, although in the English law, it must be in writing.

Illustration

A advances a loan of Rs. 5,000 to B and C promises to A that if B does not repay the loan, C will do so. This is a contract of guarantee. Here B is the principal debtor, A is the creditor and C is the surety or guarantor.

Like a contract of indemnity, a guarantee must also satisfy all the essential elements of a valid contract. There is, however, a special feature with regard to consideration in a contract of guarantee. The consideration received by the principal debtor is sufficient for surety. Section 127 provides that anything done or any promise made for the benefit of the principal debtor may be a sufficient consideration to the surety for giving the guarantee.

Illustration

(i) B requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promise to deliver the goods. This is sufficient consideration for C's promise.

(ii) A sells and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year, and promises that if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is sufficient consideration for C's promise.

Distinction between Indemnity and Guarantee

A contract of indemnity differs from a contract of guarantee in the following ways:

(a) In a contract of indemnity there are only two parties: the indemnifier and the indemnified. In a contract of guarantee, there are three parties; the surety, the principal debtor and the creditor.

(b) In a contract of indemnity, the liability of the indemnifier is primary. In a contract of guarantee, the liability of the surety is secondary. The surety is liable only if the principal debtor makes a default, the primary liability being that of the principal debtor.

(c) The indemnifier need not necessarily act at the request of the debtor; the surety gives guarantee only at the request of the principal debtor.

(d) In the case of a guarantee, there is an existing debt or duty, the performance of which is guaranteed by the surety, whereas in the case of indemnity, the possibility of any loss happening is the only contingency against which the indemnifier undertakes to indemnify.

(e) The surety, on payment of the debt when the principal debtor has failed to pay is entitled to proceed against the principal debtor in his own right, but the indemnifier cannot sue third-parties in his own name, unless there be assignment. He must sue in the name of the indemnified.

Extent of Surety's Liability

The liability of the surety is co-extensive with that of the principal debtor unless the contract otherwise provides (Section 128). A creditor is not bound to proceed against the principal debtor. He can sue the surety without sueing the principal debtor. As soon as the debtor has made default in payment of the debt, the surety is immediately liable. But until default, the creditor cannot call upon the surety to pay. In

this sense, the nature of the surety's liability is secondary.

Illustration

A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

Section 128 only explains the quantum of a surety's obligation when terms of the contract do not limit it. Conversely it doesn't follow that the surety can never be liable when the principal debtor cannot be held liable. Thus, a surety is not discharged from liability by the mere fact that the contract between the principal debtor and creditor was voidable at the option of the former, and was avoided by the former. Where the agreement between the principal debtor and creditor is void as for example in the case of minority of principal debtor, the surety is liable as a principal debtor; for in such cases the contract of the so-called surety is not collateral, but a principal contract (*Kashiba* v. *Shripat* (1894) 19 Bom. 697).

Kinds of Guarantees

A contract of guarantee may be for an existing debt, or for a future debt. It may be a specific guarantee, or it may be a continuing guarantee. A specific guarantee is given for a single debt and comes to an end when the debt guaranteed has been paid.

A continuing guarantee is one which extends to a series of transactions (Section 129). The liability of surety in case of a continuing guarantee extends to all the transactions contemplated until the revocation of the guarantee. As for instance, S, in consideration that C will employ P in collecting the rents of C's Zamindari, promises C to be responsible to the amount of Rs. 5,000 for the due collection and payment by P of these rents. This is a continuing guarantee.

Revocation of Continuing Guarantee

A continuing guarantee is revoked in the following circumstances:

(a) *By notice of revocation by the surety (Section 130):* The notice operates to revoke the surety's liability as regards future transactions. He continues to be liable for transactions entered into prior to the notice (*Offord* v. *Davies* (1862) 6 L.T.S. 79).

(b) *By the death of the surety:* The death of the surety operates, in the absence of contract (*Lloyds* v. *Harper* (188) 16 Ch. D. 290) as a revocation of a continuing guarantee, so far as regards future transactions (Section 131). But for all the transactions made before his death, the surety's estate will be liable.

Rights of Surety

A surety has certain rights against the creditor, (Section 141) the principal debtor (Sections 140 and 145) and the co-securities (Sections 146 and 147). Those are—

(a) *Surety's rights against the creditor:* Under Section 141 a surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into whether the

surety knows of the existence of such security or not; and, if the creditor losses or, without the consent of the surety parts with such security, the surety is discharged to the extent of the value of the security.

(b) *Rights against the principal debtor:* After discharging the debt, the surety steps into the shoes of the creditor or is subrogated to all the rights of the creditor against the principal debtor. He can then sue the principal debtor for the amount paid by him to the creditor on the debtors default; he becomes a creditor of the principal debtor for what he has paid.

In some circumstances, the surety may get certain rights even before payment. The surety has remedies against the principal debtor before payment and after payment. In *Mamta Ghose* v. *United Industrial Bank* (AIR 1987 Cal. 180) where the principal debtor, after finding that the debt became due, started disposing of his properties to prevent seizure by surety, the Court granted an injunction to the surety restraining the principal debtor from doing so. The surety can compel the debtor, after debt has become due to exonerate him from his liability by paying the debt.

(c) *Surety's rights gains co-sureties:* When a surety has paid more than his share of debt to the creditor, he has a right of contribution from the co-securities who are equally bound to pay with him. A, B and C are sureties to D for the sum of Rs. 3,000 lent to E who makes default in payment. A, B and C are liable, as between themselves to pay Rs. 1,000 each. If any one of them has to pay more than Rs. 1,000 he can claim contribution from the other two to reduce his payment to only Rs. 1,000. If one of them becomes insolvent, the other two shall have to contribute the unpaid amount equally.

Discharge of Surety

A surety may be discharged from liability under the following circumstances:

(a) By notice of revocation in case of a continuing guarantee as regards future transaction (Section 130.)

(b) By the death of the surety as regards future transactions, in a continuing guarantee in the absence of a contract to the contrary (Section 131).

(c) Any variation in the terms of the contract between the creditor and the principal debtor, without the consent of the surety, discharges the surety as regards all transactions taking place after the variation (Section 133).

(d) A surety will be discharged if the creditor releases the principal debtor, or acts or makes an omission which results in the discharge of the principal debtor (Section 134). But where the creditor fails to sue the principal debtor within the limitation period, the surety is not discharged.

(e) Where the creditor, without the consent of the surety, makes an arrangement with the principal debtor for composition, or promises to give time or not to sue him, the surety will be discharged (Section 135).

(f) If the creditor does any act which is against the rights of the surety, or omits to do an act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged (Section 139).

(g) If the creditor loses or parts with any security which at the time of the contract

the debtor had given in favour of the creditor, the surety is discharged to the extent of the value of the security, unless the surety consented to the release of such security by creditor in favour of the debtor. It is immaterial whether the surety was or is aware of such security or not (Section 141).

Illustrations

(1) A guarantees to B, to the extent of Rs. 10,000, that C shall pay all the bills that B shall draw upon him. B draws upon C, C accepts the bill. A gives notice of revocation, C dishonours the bill at maturity. A is liable upon his guarantee (Section 130).

(2) A becomes surety to C for B's conduct as a manager in C's bank. Afterwards B and C contract without A's consent that B's salary shall be raised and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss (Section 133).

(3) C contracts to lend B Rs. 5,000 on 1st March, A guarantees repayment. C pays the money to B on 1st of January. A is discharged from his liability, as the contract has been varied in as much as C might sue B for the money before 1st of March, (Section 133).

(4) X contracts with B to build a house for a fixed price for B within a stipulated time, B supplying the necessary timber. Z guarantees X's performance. B omits to supply the timber. Z is discharged from liability (Section 134).

(5) B contracts to build a ship for C for a given sum, to be paid by instalments as the work reaches certain stages. A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays to B the last two instalments. A is discharged by this prepayment (Section 139).

CONTRACT OF BAILMENT AND PLEDGE

(a) Bailment

A bailment is a transaction whereby one person delivers goods to another person for some purpose, upon a contract that they are, when the purpose is accomplished to be returned or otherwise disposed of according to the directions of the person delivering them (Section 148). The person who delivers the goods is called the *bailor* and the person to whom they are delivered is called the *bailee.*

Bailment is a *voluntary delivery of goods for a temporary purpose* on the understanding that *they are to be returned in* specie in the same or altered form. The ownership of the goods remains with the bailor, the bailee getting only the possession. Delivery of goods may be actual or constructive, e.g., where the key of a godown is handed over to another person, it amounts to delivery of goods in the godown.

Gratuitous Bailment

A gratuitous bailment is one in which neither the bailor nor the bailee is entitled to any remuneration. Such a bailment may be for the exclusive benefit of the bailor, e.g., when A leaves his dog with a neighbour to be looked after in A's absence on a holiday. It may again be for exclusive benefit of the bailee, e.g., where you lend your

book to a friend of yours for a week. In neither case any charge is made.

A gratuitous bailment terminates by the death of either the bailor or the bailee (Section 162).

Under Section 159 the lender of a thing for use may at any time require its return if the loan was gratuitous, even though he lent it for a specified time or purpose. But if on the faith of such loan made for a specified time or purpose, the borrower has acted in such a manner that the return of the thing lent before the time agreed upon would cause him loss exceeding the benefit actually derived by him from the loan, the lender must, if he compels the return, indemnify the borrower the amount in which the loss so occasioned exceeds the benefit so derived.

Bailment for Reward

This is for the mutual benefit of both the bailor and the bailee. For example, A lets out a motor-car for hire to B. A is the bailor and receives the hire charges and B is the bailee and gets the use of the car. Where, A hands over his goods to B, a carrier for carriage at a price, A is the bailor who enjoys the benefit of carriage and B is the bailee who receives a remuneration for carrying the goods.

Duties of Bailee

The bailee owes the following duties in respect of the goods bailed to him:

(a) The bailee must take as much care of the goods bailed to him as a man of ordinary prudence would take under similar circumstances of his own goods of the same bulk, quality and value as the goods bailed (Section 151). If he takes this much care he will not be liable for any loss, destruction or deterioration of the goods bailed (Section 152). The *degree of care required from the bailee is the same whether the bailment is for reward or gratuitous.*

Of course, the bailee may agree to take special care of the goods, e.g., he may agree to keep the property safe from all perils and answers for accidents or thefts. But even such a bailee will not be liable for loss happening by *an act of God* or by public enemies.

(b) The bailee is under a duty not to use the goods in an unauthorised manner or for unauthorised purpose (Section 153). If the does so, the bailor can terminate the bailment and claim damages for any loss or damage caused by the unauthorised used (Section 154).

(c) He must keep the goods bailed to him separate from his own goods (Sections 155-157).

If the bailee without the consent of the bailor, mixes the goods of the bailor with his own goods, the bailor and the bailee shall have an interest, in production to their respective shares, in the mixture thus produced. If the bailee without the consent of the bailor, mixes the goods of the bailor with his own goods, and the goods can be separated or divided, the property in the goods remains in the parties respectively; but the bailee is bound to bear the expenses of separation, and any damages arising from the mixture.

If the bailee without the consent of the bailor mixes, the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is

entitled to be compensated by the bailee for the loss of goods.

(d) He must not set up an adverse title to the goods.

(e) It is the duty of the bailee to return the goods without demand on the expiry of the time fixed or when the purpose is accomplished (Section 160). If he fails to return them, he shall be liable for any loss, destruction or deterioration of the goods even without negligence on his part (Section 161).

(f) In the absence of any contract to the contrary, the baliee must return to the bailor any increase, or profits which may have accrued from the goods bailed; for example, when A leaves a cow in the custody of B to be taken care of and the cow gets a calf, B is bound is deliver the cow as well as the calf to A (Section 163).

Bailees Particular Lien (Section 170)

Where the goods are bailed for a particular purpose and the bailee in due performance of bailment, expands his skill and labour, he has in the absence of an agreement to the contrary a lien on the goods, i.e., the bailee can retain the goods until his charges in respect of labour and skill used on the goods are paid by the bailor. A gives a piece of cloth to B, a tailor, for making it into a suit, B promises to have the suit ready for delivery within a fortnight, B has the suit ready for delivery. He has a right to retain the suit until he is paid his dues. The section expresses the Common Law principle that if a man has an article delivered to him on the improvement of which he has to bestow trouble and expenses, he has a right to detain it until his demand is paid.

The right of lien arises only where labour and skill have been used so as to confer an additional value on the article.

Particular and General Lien

Lien is of two kinds: Particular lien and General lien. A particular lien is one which is available only against that property of which the skill and labour have been exercised. A bailee's lien is a particular lien.

A *general lien* is a right to detain any property belonging to the other and in the possession of the person trying to exercise the lien in respect of any payment lawfully due to him.

Thus, a general lien is the right to retain the property of another for a general balance of accounts but a particular lien is a right to retain only for a charge on account of labour employed or expenses bestowed upon the identical property detained.

The right of general lien is expressly given by Section 171 of the Indian Contract Act to bankers, factors, warfingers, attorneys of High Court and policy-brokers, provided there is no agreement to the contrary.

Duties of bailor

The bailor has the following duties:

(a) The bailor must disclose all the known faults in the goods; and if he fails to do that, he will be liable for any damage resulting directly from the faults (Section 150). For example, A delivers to B, a carrier, some explosive in a

case, but does not warn B. The case is handled without extraordinary care necessary for such articles and explodes. A is liable for all the resulting damage to men and other goods.

In the case of bailment for hire, a still greater responsibility is placed on the bailor. He will be liable even if he did not know of the defects (Section 150). A hires a carriage of B. The carriage is unsafe though B does not know this. A is injured. B is responsible to A for the injury.

(b) It is the duty of the bailor to pay any extraordinary expenses incurred by the bailee. For example, if a horse is lent for a journey, the expense of feeding the house would, of course, subject to any special agreement be borne by the bailee. If however the horse becomes ill and expenses have been incurred on its treatment, the bailor shall have to pay these expenses (Section 158).

(c) The bailor is bound to indemnify the bailee for any cost or costs which the bailee may incur because of the defective title of the bailor of the goods bailed (Section 164).

Termination of bailment

Where the bailee wrongfully uses or dispose of the goods bailed, the bailor may determine the bailment (Section 153.)

As soon as the period of bailment expires or the object of the bailment has been achieved, the bailment comes to an end, and the bailee must return the goods to the bailor (Section 160). Bailment is terminated when the subject matter of bailment is destroyed or by reason of change in its nature, becomes incapable of use for the purpose of bailment.

A gratuitous bailment can be terminated by the bailor at any time, even before the agreed time, subject to the limitation that where termination before the agreed period causes loss in excess of benefit, the bailor must compensate the bailee (Section 159).

A gratuitous bailment terminates by the death of either the bailor or the bailee (Section 162).

Finder of Lost Goods

The position of a finder of lost goods is exactly that of a bailee. The rights of a finder are that he can sue the owner for any reward that might have been offered, and may retain the goods until he receives the reward. But where the owner has offered no reward, the finder has only a particular lien and can detain the goods until he receives compensation for the troubles and expenses incurred in preserving the property for finding out the true owner. But he cannot file a suit for the recovery of the compensation [Section 168].

Thus, as against the true owner, the finder of goods in a public or quasi public place is only a bailee; he keeps the article in trust for the real owner. As against every-one else, the property in the goods vests in the finder on his taking possession of it.

The finder has a right to sell the property—

(a) where the owner cannot with reasonable diligence be found, or

(b) when found, he refuses to pay the lawful charges of the finder and—

(i) if the thing is in danger of perishing or losing greater part of its value, or

(ii) when the lawful charges of the finder for the preservation of goods and the finding out of the owner amounts to two-thirds of the value of the thing (Section 169).

Carrier as Bailee

A common carrier undertakes to carry goods of all persons who are willing to pay his usual or reasonable rates. He further undertakes to carry them safely, and make good all loses, unless they are caused by act of God or public enemies. Carriers by land including railways and carriers by inland navigation, are common carriers. Carriers by Sea for hire are not common carriers and they can limit their liability. Railways in India are now common carriers.

Inn-keepers: The liability of a hotel keeper is governed by Sections 151 and 152 of the Contract Act and is that of an ordinary bailee with regard to the property of the guests.

C stayed in a room in a hotel. The hotel-keeper knew that the room was in an insecure condition. While C was dining in the dining room, some articles were stolen from his room. It was held that the hotel-keeper was liable as he should have taken reasonable steps to rectify the insecured condition of the rooms (*Jan & San* v. *Caneron* (1922) 44 All. 735).

(b) Pledge

Pledge or pawn is a contract whereby an article is deposited with a lender of money or promisee as security for the repayment of a loan or performance of a *promise*. The bailor or depositor is called the Pawnor and the bailee or depositee the "Pawnee" (Section 172). Since pledge is a branch of bailment, the pawness is bound to take reasonable care of the goods pledged with him. Any kind of goods, valuables, documents or securities may be pledged. The Government securities, e.g., promissory notes must, however, be pledged by endorsement and delivery.

The following are the essential ingredients of a pledge:

(i) The property pledged should be delivered to the pawnee.

(ii) Delivery should be in pursuance of a contract.

(iii) Delivery should be for the purpose of security.

(iv) Delivery should be upon a condition to return.

Rights of the Pawnee

No property in goods pawned passes to the pawnee, but the pawnee gets a "special property to retain possession even against the true owner until the payment of the debt, interest on the debt, and any other expense incurred in respect of the possession or for preservation of the goods pledged" (Section 173). The pawnee must return the goods to the pawnor on the tender of all that is due to him. The pawnee cannot confer a good title upon a *bona fide* purchaser for value.

Should the pawnor make a default in payment of the debt or performance of the promise at the stipulated time, the pawnee may-

(i) file a suit for the recovery of the amount due to him while retaining the goods pledged as collateral security; or

(ii) sue for the sale of the goods and the realisation of money due to him; or

(iii) himself sell the goods pawned, after giving reasonable notice to the pawnor, sue for the deficiency, if any, after the sale.

If the sale is made in execution of a decree, the pawnee may buy the goods at the sale. But he cannot sell them to himself in a sale made by himself under (iii) above. If after sale of the goods, there is surplus, the pawnee must pay it to the pawnor (Section 176).

Rights of Pawnor

On default by pawnor to repay on the stipulated date, the pawnee may sell the goods after giving reasonable notice to the pawnor. If the pawnee makes an unauthorised sale without giving notice to the pawnor, the pawnor has the following rights—

(i) He can file a suit for redemption of goods by depositing the money treating the sale as if it had never taken place; or

(ii) He can ask for damages on the ground of conversion.

Pledge by Non-owners

Ordinarily, the owner of the goods would pledge them to secure a loan but the law permits under certain circumstances a pledge by a person who is not the owner but is in possession of the goods. Thus, a valid pledge may be created by the following non-owners.

(a) *A mercantile agent:* Where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, is as valid as if he were expressly authorised by the owner of the goods to make the same. But the pledge is valid only if the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor has not the authority to pledge (Section 178).

(b) *Pledge by seller or buyer in possession after sale:* A seller, left in possession of goods sold, is no more the owner, but pledge by him will be valid, provided the pawnee acted in good faith and had no notice of the sale of goods to the buyer (Section 30 of The Sale of Goods Act 1930).

(c) *Pledge where pawnor having limited interest:* When the pawnor is not the owner of the goods but has a limited interest in the goods which he pawns, e.g., he is a mortgagee or he has a lien with respect of these goods, the pledge will be valid to the extent of such interest.

(d) *Pledge by co-owner in possession:* One of the several co-owners of goods in possession thereof with the assent of the other co-owners may create a valid pledge of the goods.

(e) *Pledge by person in possession under a voidable contract:* A person may obtain possession under a contract which is voidable at the option of the lawful owner on the ground of misrepresentation, fraud, etc. The person in possession may pledge the goods before the contract is avoided by the other party (Section 178A).

LAW OF AGENCY

Definition of Agent (Section 182)

An agent is a person who is employed to bring his principal into contractual relations with third-parties. As the definition indicates, an agent is a mere connecting link between the principal and a third-party. But during the period that an agent is acting for his principal, he is clothed with the capacity of his principal.

Creation of Agency

A contract of agency may be express or implied, (Section 186) but consideration is not an essential element in this contract (Section 185). Agency may also arise by estoppel, necessity or ratification.

(a) *Express Agency:* A contract of agency may be made orally or in writing. The usual form of written contract of agency is the Power of Attorney, which gives him the authority to act on behalf of his principal in accordance with the terms and conditions therein. In an agency created to transfer immovable property, the power of attorney must be registered. A power of attorney may be general, giving several powers to the agent, or special, giving authority to the agent for transacting a single act.

(b) *Implied Agency:* Implied agency may arise by conduct, situation of parties or necessity of the case.

(i) *Agency by Estoppel* (Section 237): Estoppel arises when you are precluded from denying the truth of anything which you have represented as a fact, although it is not a fact. Thus, where P allows third-parties to believe that A is acting as his authorised agent, he will be estopped from denying the agency if such third-parties relying on it make a contract with A even when A had no authority at all.

(ii) *Wife as agent:* Where a husband and wife are living together, the wife is presumed to have her husbands authority to pledge his credit for the purchase of necessaries of life suitable to their standard of living. But the husband will not be liable if he shows that (i) he had expressly warned the trademan not to supply goods on credit to his wife; or (ii) he had expressly forbidden the wife to pledge his credit; or (iii) his wife was already sufficiently supplied with the articles in question; or (iv) she was supplied with a sufficient allowance.

Similarly, where any person is held out by another as his agent, the third-party can hold that person liable for the acts of the ostensible agent, or the agent by holding out. Partners are each others agents for making contracts in the ordinary course of the partnership business.

(iii) *Agency of Necessity* (Sections 188 and 189): In certain circumstances, a person who has been entrusted with anothers property, may have to incur unauthorised expenses to protect or preserve it. Such an agency is called an agency of necessity. For example, A sent a horse by railway and on its arrival at the destination there was no one to receive it. The railway company, being bound to take reasonable steps to keep the horse alive, was an agent of necessity of A.

A wife deserted by her husband and thus forced to live separate from him,

can pledge her husbands credit to buy all necessaries of life according to the position of the husband even against his wishes.

(iv) *Agency by ratification* (Sections 169-200): Where a person having no authority purports to act as agent, or a duly appointed agent exceeds his authority, the principal is not bound by the contract supposedly based on his behalf. But the principal may ratify the agents transaction and so accept liability. In this way an agency by ratification arises. This is also known as *ex post facto agency*—agency arising after the event. The effect of ratification is to render the contract binding on the principal as if the agent had been authorised before hand. Also ratification relates back to the original making of the contract so that the agency is taken to have come into existence from the moment the agent first acted, and not from the date the principal ratified it. Ratification is effective only if the following conditions are satisfied—

(a) The agent must expressly contract as agent for a principal who is in existence and competent to contract.

(b) The principal must be competent to contract not only at the time the agent acted, but also when he ratified the agents act.

(c) The principal at the time of ratification has full knowledge of the material facts, and must ratify the whole contract, within a reasonable time.

(d) Ratification cannot be made so as to subject a third-party to damages, or terminate any right or interest of a third person.

(e) Only lawful acts can be ratified.

Classes of Agents

Agents may be special or general or, they may be mercantile agents:

(a) *Special Agent:* A special agent is one who is appointed to do a specified act, or to perform a specified function. He has no authority outside this special task. The third-party has no right to assume that the agent has unlimited authority. Any act of the agent beyond that authority will not bind the principal.

(b) *General Agent:* A general agent is appointed to do anything within the authority given to him by the principal in all transactions, or in all transactions relating to a specified trade or matter. The third-party may assume that such an agent has power to do all that is usual for a general agent to do in the business involved. The third party is not affected by any private restrictions on the agents authority.

Sub-Agent

A person who is appointed by the agent and to whom the principal's work is delegated to known as sub-agent. Section 191 provides that "a sub-agent is a person employed by, and acting under the control of the original agent in the business of the agency." So, the sub-agent is the agent of the original agent.

As between themselves, the relation of sub-agent and original agent is that of agent and the principal. A sub-agent is bound by all the duties of the original agent. The sub-agent is not directly responsible to the principal except for fraud and wilful wrong. The sub-agent is responsible to the original agent. The original agent is responsible to the principal for the acts of the sub-agent. As regards third persons, the principal is represented by sub-agent and he is bound and responsible for all the acts of sub-agent as if he were an agent originally appointed by the principal.

Mercantile Agents

Section 2(9) of the Sale of Goods Act, 1930, defines a mercantile agent as "a mercantile agent having in the customary course of business as such agent authority either to sell goods or consign goods for the purposes of sale, or to buy goods, or to raise money on the security of goods". This definition covers factors, brokers, auctioneers, commission agents etc.

Factors

A factor is a mercantile agent employed to sell goods which have been placed in his possession or contract to buy goods for his principal. He is the apparent owner of the goods in his custody and can sell them in his own name and receive payment for the goods. He has an insurable interest in the goods and also a general lien in respect of any claim he may have arising out of the agency.

Brokers

A broker is a mercantile agent whose ordinary course of business is to make contracts with other parties for the sale and purchase of goods and securities of which he is not entrusted with the possession for a commission called brokerage. He acts in the name of principal. He has no lien over the goods as he is not in possession of them.

***Del Credere* Agent**

A *del credere* agent is a mercantile agent, who is consideration of an extra remuneration guarantees to his principal that the purchasers who buy on credit will pay for the goods they take. In the event of a third-party failing to pay, the *del credere* agent is bound to pay his principal the sum owned by third-party.

Auctioneers

An auctioneer is an agent who sells goods by auction, i.e., to the highest bidder in public competition. He has no authority to warrant his principals title to the goods. He is an agent for the seller but after the goods have been knocked down he is agent for the buyer also for the purpose of evidence that the sale has taken place.

Partners

In a partnership firm, every partner is an agent of the firm and of his co-partners for the purpose of the business of the firm.

Bankers

The relationship between a banker and his customer is primarily that of debtor and creditor. In addition, a banker is an agent of his customer when he buys or sells securities, collects cheques dividends, bills or promissory notes on behalf of his customer. He has a general lien on all securities and goods in his possession in respect of the general balance due to him by the customer.

Duties of the Agent

An agent's duties towards his principal are as follows (which give corresponding rights to the principal who may sue for damages in the event of a breach of duty by the agent):

(a) An agent must act within the scope of the authority conferred upon him and

carry out strictly the instructions of the principal (Section 211).

(b) in the absence of express instructions, he must follow the custom prevailing in the same kind of business at the place where the agent conducts the business (Section 211).

(c) He must do the work with reasonable skill and diligence whereby the nature of his profession, the agent purports to have special skill, he must exercise the skill which is expected from the members of the profession (Section 212).

(d) He must disclose promptly any material information coming to his knowledge which is likely to influence the principal in the making of the contract.

(e) He must not disclose confidential information entrusted to him by his principal (Section 213).

(f) He must not allow his interest to conflict with his duty, e.g., he must not compete with his principal (Section 215).

(g) The agent must keep true accounts and must be prepared on reasonable notice to render an account.

(h) He must not make any secret profit; he must disclose any extra profit that he may make.

Where an agent is discovered taking secret bribe, etc., the principal is entitled to (i) dismiss the agent without notice, (ii) recover the amount of secret profit, and (iii) refuse to pay the agent his remuneration. He may repudiate the contract, if the third-party is involved in secret profit and also recover damages.

(i) An agent must not delegate his authority to sub-agent. A sub-agent is a person employed by and acting under the control of the original agent in the business of agency (Section 191). This rule is based on the principle: *Delegatus non-protest delegare*—a delegate cannot further delegate (Section 190).

But there are exceptions to this rule and the agent may delegate (i) where delegation is allowed by the principal, (ii) where the trade custom or usage sanctions delegation, (iii) where delegation is essential for proper performance, (iv) where an emergency renders it imperative, (v) where nature of the work is purely ministerial, and (vi) where the principal knows that the agent intends to delegate.

Rights of Agents

Where the services rendered by the agent are not gratuitous or voluntary, the agent is entitled to receive the agreed remuneration, or if none was agreed, a reasonable remuneration. The agent becomes entitled to receive remuneration as soon as he has done what he had undertaken to do (Section 219).

Certain classes of agents, e.g., factors who have goods and property of their principal in their possession, have a lien on the goods or property in respect of their remuneration and expense and liabilities incurred. He has a right to stop the goods in transit where he is an unpaid seller.

As the agent represents the principal, the agent has a right to be indemnified by the principal against all charges, expenses and liabilities properly incurred by him in

the course of the agency (Sections 222-223).

Extent of Agent's Authority

The extent of the authority of an agent depends upon the terms expressed in his appointment or it may be implied by the circumstances of the case. The contractual authority is the real authority, but implied authority is to do whatevers incidental to carry out the real authority. This implied authority is also known as apparent or ostensible authority, Thus, an agent having an authority to do an act has authority to do everything lawful which is necessary for the purpose or usually done in the course of conducting business.

An agent has authority to do all such things which may be necessary to protect the principal from loss in an emergency and which he would do to protect his own property under similar circumstances. Where butter was becoming useless owing to delay in transit and was therefore sold by the station master for the best price available as it was not possible to obtain instructions from the principal, the sale was held binding upon the principal.

Responsibilities of Principal to Third-parties

The effect of a contract made by an agent varies according to the circumstances under which the agent contracted. There are three circumstances in which an agent may contract, namely—

(i) the agent acts for a named principal;

(ii) the agent acts for an undisclosed principal; and

(iii) the agent acts for a concealed principal.

(a) *Disclosed principal:* Where the agent contracts as agent for a named principal, he generally incurs neither rights nor liabilities under the contract, and drops out as soon as it is made. The contract is made between the principal and the third-party and it is between these two that rights and obligations are created. The legal effect is the same as if the principal had contracted directly with the third-party.

The effect is that the principal is bound by all acts of the agent done within the scope of actual, apparent or ostensible authority. This ostensible authority of the agent is important, for the acts of a general agent are binding on the principal if they are within the scope of his apparent authority, although they may be outside the scope of his actual authority. Therefore, a private or secret limitation or restriction of powers of an agent do not bind innocent third-party.

(b) *Undisclosed principal:* Where the agent disclose that he is merely an agent but conceals the identity of his principal, he is not personally liable, as the drops out in normal way. The principal, on being discovered, will be responsible for the contract made by the agent.

(c) *Concealed principal:* Where an agent appears to be contracting on his own behalf, without either contracting as an agent or disclosing the existence of an agency (i.e., he discloses neither the name of the principal nor his existence), he becomes personally liable. The third-party may sue either the principal (when discovered) or the agent or both. If the third-party chooses to sue the principal and not the agent, he must allow the principal the benefit of all payments made by him to the agent on account of the contract before the agency was disclosed. The third-party

is also entitled to get the benefit of anything he may have paid to the agent.

If the principal discloses himself before the contract is completed, the other contracting party may refuse to fulfil the contract if he can show that, if he had known who was the principal in the contract, or if he had known that the agent was not the principal, he would not have entered into the contract.

Principal Liable for Agent's Torts (Section 238)

If an agent commits a tort or other wrong (e.g., misrepresentation or fraud) during his agency, whilst acting within the scope of his actual or apparent authority, the principal is liable. But the agent is also personally liable, and he may be sued also. The principal is liable even if the tort is committed exclusively for the benefit of the agent and against the interests of the principal.

Personal Liability of Agent to Third-party

An agent is personally liable in the following cases:

(a) Where the agent has agreed to be personally liable to the third-party.

(b) Where an agent acts for a principal residing abroad.

(c) When the agent signs a negotiable instrument in his own name without making it clear that he is signing it only as agent.

(d) When an agent acts for a principal who cannot be sued (e.g., he is minor), the agent is personally liable.

(e) An agent is liable for breach of warranty of authority. Where a person contracts as agent without any authority there is a breach of warranty of authority. He is liable to the person who has relied on the warranty of authority and has suffered loss.

(f) Where authority is one coupled with interest or where trade, usage or custom makes the agent personally liable, he will be liable to the third-party.

(g) He is also liable for his torts committed in the course of agency.

Meaning of Authority Coupled with Interest (Section 202)

An agency is coupled with an interest when the agent has an interest in the authority granted to him or when the agent has an interest in the subject matter with which he is authorised to deal. Where the agent was appointed to enable him to secure some benefit already owed to him by the principal, the agency was coupled with an interest. For example, where a factor had made advances to the principal and is authorised to sell at the best price and recoup the advances made by him or where the agent is authorised to collect money from third-parties and pay himself the debt due by the principal, the agencies are coupled with interest. But a mere arrangement that the agent's remuneration to paid out of the rents collected by him, it does not give him any interest in the property and the agency is not the one coupled with an interest. An agency coupled with interest cannot be terminated in the absence of a contract to the contrary to the prejudice of such interest.

The principal laid down in Section 202 applies only if the following conditions are fulfilled:

(i) The interest of the agent should exist at the time of creation of agency and

should not have arisen after the creation of agency.

(ii) Authority given to the agent must be intended for the protection of the interest of the agent.

(iii) The interest of the agent in the subject matter must be substantial and not ordinary.

(iv) The interest of the agent should be over and above his remuneration. Mere prospect of remuneration is not sufficient interest.

Termination of Agency

An agency comes to an end or terminates—

(a) By the performance of the contract of agency; (Section 201)

(b) By an agreement between the principal and the agent;

(c) By expiration of the period fixed for the contract of agency;

(d) By the death of the principal or the agency; (Section 201)

(e) By the insanity of either the principal or the agent; (Section 201)

(f) By the insolvency of the principal, and in some cases that of the agent; (Section 201)

(g) Where the principal or agent is an incorporated company, by its dissolution;

(h) By the destruction of the subject-matter; (Section 56)

(i) By the renunciation of his authority by the agent; (Section 201)

(j) By the revocation of authority by the principal. (Section 201)

When Agency is Irrevocable

Revocation of an agency by the principal is not possible in the following cases:

(a) Where the authority of agency is one coupled with an interest, even the death or insanity of the principal does not terminate the authority in this case (Section 202).

(b) When agent has incurred personal liability, the agency becomes irrevocable.

(c) When the authority has been partly exercised by the agent, it is irrevocable in particular with regard to obligations which arise from acts already done (Section 204).

When Termination Takes Effect

Termination of an agency takes effect or is complete, as regards the agent when it becomes known to the agent. If the principal revokes the agents authority, the revocation will take effect when the agent comes to know of it. As regards the third-parties, the termination takes effect when it comes to their knowledge (Section 208). Thus, if an agent whose authority has been terminated to his knowledge, enters into a contract with a third-party who deals with him *bona fide*, the contract will be binding on the principal as against the third-party. The termination of an agent's authority terminates the authority of the sub-agent appointed by the agent (Section 210).

The revocation of agency as regards the agent and as regards the principal takes effect at different points of time. Section 209 charges the agent with duty to protect the principal's interest where the principal dies or becomes of unsound mind. It

provides that when an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interest entrusted to him. So it is the duty of the agent to take all steps to protect the interest of his deceased principal on his death.

SELF TEST QUESTIONS

1. (a) Define consideration and state its essential features.
   (b) "No consideration, no contract". Do you agree?
2. "The essence of every agreement is that there ought be free consent on both the sides". Discuss.
3. How does a binding contract differ from other agreements?
4. (a) When is communication of an offer complete?
   (b) What is (i) a general offer (ii) an acceptance by conduct?
5. Comment on the following:
   (a) "The legal effect of a contract is confined to the contracting parties".
   (b) "Mere silence may amount to fraud".

   Tick (✓) the correct answer
   (a) All agreements are/are not contracts.
   (b) An offer and an invitation to make an offer are/are not the samething.
   (c) To be enforceable at law, all contracts must have/need not have considerations.
   (d) Misrepresentation and Fraud are/are not the something.
   (e) There is/there is no difference between void and illegal contracts.
   (f) Indemnity and guarantee are/are not the samething.
6. Indicate whether the following statements are true or false.
   (a) An invitation to treat is not an offer.
   (b) Communication of acceptance of a general offer is optional.
   (c) Display of goods in a shop-window with prices marked on them is an offer to sell.
   (d) An offer cannot be revoked by the offeror after the letter of acceptance has been posted.
   (e) An offer lapses by the death of an offeree before acceptance.
7. State whether any contract is made in the following cases:
   (a) When you invite B to your home for dinner and B accepts your invitation.
   (b) When you board a public bus.
   (c) When you call a taxi on the telephone.
   (d) When you put a one rupee coin in the slot of a weighing machine.
   (e) When you eat a meal at a restaurant.
8. Discuss Quasi Contractual obligations under the Indian Contract Act, 1872.

9. When does the Court refuse to grant specific performance in case of breach of contract by one of the parties?
10. Write short notes on:
    (a) Reciprocal promises.
    (b) "The law does not compel the impossible".
    (c) Substituted Agent.
    (d) Liquidated Damages.
11. (a) Discuss the contractual liability of a minor.
    (b) A, a minor, enters, into the following contracts. Is he and the other party bound by any of them?
        (a) C contracts to marry B, aged 19 years.
        (b) A boards a bus.
        (c) A lends Rs. 500 to B, aged 25 years.
        (d) A becomes an apprentice in an industrial concern.
        (e) A buys a TV set on credit.
12. State whether the following statements are true or false:
    (a) Every alien is an enemy.
    (b) A Corporation can contract only through agents.
    (c) A married woman has no capacity to contract.
    (d) A mistake of law is as fatal to a contract as a mistake of fact.
13. Distinguish between innocent misrepresentation and fraud.
14. Is an immoral agreement necessarily illegal?
15. Can A recover the amount promised to him by B in the following cases?
    (a) A procured B a second wife on B's promise to pay him Rs. 500.
    (b) B has promised to pay A Rs. 1,000 for his horse which had died before the contract
    (c) B, a minor, promised to pay A Rs. 10,000 for his car.
    (d) B promised to pay his son A Rs.,10,000 if he would not marry C.
16. State whether the following statements are true or false:
    (a) An agreement in restraint of trade is always void.
    (b) Wagering agreements are illegal in all parts of India.
    (c) There is no restitution where a minor is a party to a contract.
    (d) A quasi-contract is not a full contract; it is a semi-contract.
    (e) A liability under a contract cannot be assigned.
    (f) Specific performance will be ordered in all cases in which an injunction can be granted.
17. Enumerate the different modes of discharge of a contract.
18. Illustrate the meaning of anticipatory breach of contract.
19. Distinguish between:
    (a) Liquidated and unliquidated damages;

(b) Liquidated damages and penalty;
(c) Indemnity and Guarantee;
(d) Sub-agent and Substituted Agent.

20. State whether the following statements are true or false:
    (a) Surety enjoys a right of subrogation.
    (b) Failure to sue the principal debtor within time, discharges the surety.
    (c) Money deposited in fixed deposit with a bank is bailment.
    (d) A bailee under a gratuitous bailment need not take as much care of the goods bailed as in case of bailment for reward.
    (e) A bailee has a rights of general lien.
    (f) A pawnee can sell the goods pawned on default by pawnor.
21. What are the rights and duties of a finder of goods? What is the nature of lien which finder of lost goods has over the goods?
22. State and responsibilities of the principal when he is disclosed, undisclosed, and concealed.
23. When is an agent personally liable for the contracts made by him on behalf of his principal? How agency relationship arises by "ratification" and "estoppel".
24. What is gratuitous bailment? Give illustrations. Described the duties and responsibilities of a bailee.
25. What is meant by ratification? What are the requirements of valid ratification?
26. Distinguish between particular lien and general lien? Who are entitle to general lien?

PRACTICAL PROBLEMS

1. A on board an English ship on the high seas, causes B to enter into an agreement by an act amounting to criminal intimidation under the Indian Penal Code. A afterwards sues B for breach of contract at Calcutta. Has A employed any coercion?
2. X having advanced money to his son Y, during the minority, upon Y's becoming major obtains by misuse of parental influence a bond from Y for a greater amount than the sum due in respect of the advances. Has X employed undue influence?
3. A sells by auction, to B a horse which A knows to be unsound. A says nothing to B about the horses unsoundness. Is A guilty of fraud.
4. A and B are traders and enter into some contract. A has private information of a change in price which would effect B's willingness to proceed with the contract. Is A bound to inform B.
5. A intending to deceive B falsely represents that five hundred paunds of indigo are made annually at A's factory and thereby induces B to buy the factory. What is the remedy available to B.
6. A's son has forged B's name to a promissory note. B, under threat of prosecuting A's son obtains a bond from A for the amount of the forged note. Can B sue on this bond.
7. A agrees to buy from B a certain horse. It turns out that the horse was dead

at the time of the bargain, though neither party was aware of the fact. Is the agreement valid?

8. A promises to obtain for B an employment in the public service and B promises to pay Rs. 1,000 to A. Is this valid contract.
9. A's estate is sold for arrears of revenue under the provisions of an Act of legislature by which the defaulter is prohibited from purchasing the estate. B, upon an understanding with A, becomes the purchaser and agrees to convey the estate to A upon receiving from him the price which B has paid. Is the agreement valid.
10. X promises to superintend on behalf of Y a legal manufacturer of indigo and illegal traffic in cosmetic. Y promises to pay to X Rs. 20,000 a year for this. Is the agreement valid?
11. A owes to B Rs. 1,000 but the debt is barred by the Limitation Act. A orally promises to pay the debt. Can B recover the money from A.
12. A is dealer in different kinds of oil. He agrees to sell B "a hundred tonnes of oil. "Is there any agreement"?
13. A agrees to sell B all the rice in his godown. Is it a valid agreement?
14. C contracts to pay A Rs. 10,000 if his car is destroyed. What is the nature of his contract?
15. A makes a contract with B to buy B's car if A survives C. Can contract be enforced before C dies?
16. A agrees to pay B a sum of money if B marries C. C married D. What is the consequence?
17. A promises to paint a picture for B within a month for a price. A dies shortly thereafter. Can B enforce the contract against the legal representatives of A.
18. A, a singer enters into a contract with B, the manager of a theatre, to sing at this theatre two nights in every week during the next two months and is engaged to pay her Rs. 100 for each night's performance. On the sixth night, A wilfully absents herself from the theatre. Can B put an end the contract.
19. A, B and C jointly promise to pay D a sum of Rs. 1,500. C is compelled to pay the whole amount. A is insolvent but his assets are sufficient to pay one half of his debts. How much C is entitled to recover from A and B's estates.
20. A promises to deliver 50 rice bags at B's warehouse on 1st January. A brings the goods as promised but after the usual business hours. Has A performed his promise?
21. X undertakes to deliver 100 bags of wheat to Y on an appointed day. Is X bound to fix the place of delivery?
22. X promises to build a stable for Y's horse and Y promises to pay X on completion of the work. Half-way during construction X demands money from Y. Can Y refuses to pay?
23. P contracts with Q to execute some construction work for a fixed price, Q supplying the scaffolding and timber necessary for the work. Q fails to supply the necessary scaffolding and timber. Can P refuse to execute the construction work? Can P claim damages for loss arising for Qs non-performance.

24. X owes money to Y under a contract. It is agreed between X, Y and Z that Y will accept Z as has debtor instead of X. Is the old debt extinguished?
25. X, a trader leaves goods at Y's house by mistake. Y treats the goods as his own. What is remedy available to X.
26. X and Y jointly owe Rs. 1,000 to Z. X of his own pays the whole amount to Z and Y not knowing this also pays the amount to Z. Can Y subsequently recover the amount from Z.
27. A contracts to buy B's scooter for Rs. 7,800, but breaks his promise. B could obtain another scooter immediately after the breach for Rs. 8,500. Can B recover the excess of Rs. 700.
28. A contracts to sell and deliver 25,000 tonnes of certain raw material to B on a fixed day. A knows nothing of B's mode of conducting his business. A breaks his promise and B having no raw material is obliged to close his factory. Is B entitled to recover the loss caused by such closure?
29. A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. Is A liable for the interest on the amount of the bill due.
30. A guarantees to B to the extent of Rs. 1,000 that C shall pay all the bills that B shall draw upon him. B draws upon C. C accepts the bill. A gives a notice of revocation. Is A liable if C dishonours the bill at maturity?
31. A agrees to appoint B as salesman in his office at a monthly salary of Rs. 300 upon C becoming a surety for B's duty accounting of the monies received by him. Afterwards without C's knowledge or consent, A agreed to pay B commission on the collections instead of monthly salary. Is C liable for any subsequent misconduct of B?
32. A owes money to B which has been guaranteed by C. The debt becomes due, but B does not sue A for a year thereafter. Is C discharged from liability?
33. X guarantees to Z payment for iron to be supplied by him to Y to the extent of 20,000 tonnes. Y and Z have privately agreed that Y should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of old debt. This agreement is concealed from X. Is X liable.
34. A, B and C as sureties for D enter into several bonds each in a different penalty namely, A in the penalty of Rs. 10,000, B in that of Rs. 20,000 and C in that of Rs. 40,000 conditioned for D's duty accounting to E. D makes a default to the extent of Rs. 30,000. How much A, B and C are liable to pay?
35. A lends a cycle which he knows is defective to B. B is injured while driving. Is A liable for injuries sustained?
36. A lends his car to B on the express understanding that only B should drive it. But B's son drives the car. In spite of all his diligence the car meets with an accident and is severely damaged? Is B liable for damage?
37. A leaves a cow in the custody of B to be taken care of. The cow begets a calf. Is B bound to redeliver the calf also.
38. A delivers his two wrist watches for repair to B. B keeps both the watches duly repaired. A is prepared to take back one of the watches on payment of

the charge for repairing it but B refuses to deliver both the watches. Is B justified?

39. A has an agent at Calcutta namely B to whom he sends certain goods with directions to send them immediately to Lucknow. But B finds that the goods may not stand the journey to Lucknow and sells them at Calcutta itself. Is he justified in doing so?
40. A without authority buys goods for B. Afterwards B sell them to C on his own account. Does he ratify the act of A?
41. A holds a lease from B terminable on 3 months notice. C an unauthorised person gives notice of termination to A. Can the notice be ratified by B?
42. X gives authority to Y to sell X's land, to pay himself out of the proceeds the debts due to him. Can X revoke this authority?
43. A authorises B to let A's house. Afterwards A lets it himself. Is the authority of B revoked?
44. A has authority from his principal B to sell goods on credit. A sells goods on credit to C without making the proper and usual enquiries as to C's solvency. C at the time of such sale was insolvent. Should A compensate B?
45. X directs Y his agent to buy a certain house for him. Y tells X that it cannot be bought but buys the house himself later. Can X on discovering this compel Y to sell it to him?
46. A employs B to beat C and agrees to indemnify him against all consequences. B beats C and had to pay damages to C. Is A bound to indemnify B?
47. A enters into a contract with B to sell him 100 bales of cotton and afterwards discovers that B was acting as agent for C. Whom can A sue?
48. X entrusts B with a negotiable instrument endorsed in blank. Y makes over the instrument to C in violation of the private orders of X. Is it a valid act?

Hints for Answers

1. Yes, A has employed coercion—Refer Section 15 of the Indian Contract Act.
2. Yes, vide Section 16 of the Indian Contract Act.
3. No, vide Section 17 of the Indian Contract Act.
4. No, vide Section 17 of the Indian Contract Act.
5. B may rescind the contract vide Section 19 of the Indian Contract Act.
6. No, the Court may set bond aside vide Section 19-A of the Indian Contract Act.
7. No, the agreement is void—vide Section 20 of the Indian Contract Act.
8. No, it is void as the consideration is unlawful vide Section 23 of the Indian Contract Act.
9. Yes, it would defeat the object of law, vide Section 23 of the Indian Contract Act.
10. No, the consideration is partly unlawful—vide Section 24 of the Indian Contract Act.
11. No, because the promise to pay is not in writing.

12. No, because of want of certainty as to the kind of oil vide Section 29 of the Indian Contract Act.
13. Yes, because there is no uncertainly.
14. It is a contingent contract—vide Section 31 of the Indian Contract Act.
15. No, vide Section 32 of the Indian Contract Act.
16. The marriage of B and C must be now considered impossible—vide Section 34 and hence the contract deemed to be void—Section 36 of the Indian Contract Act.
17. No, vide Section 37 of the Indian Contract Act.
18. Yes, vide Section 39 of the Indian Contract Act.
19. C, can recover Rs. 250 and Rs. 625 from A and B's estate respectively vide Section 43 of the Indian Contract Act.
20. No, vide Section 47 of the Indian Contract Act.
21. Yes, vide Section 49 of the Indian Contract Act.
22. Yes, vide Section 52 of the Indian Contract Act.
23. Yes, P can refuse and P can also claim damages vide Section 53 of the Indian Contract Act.
24. Yes, by novation vide Section 62 of the Indian Contract Act.
25. X, can sue for the price of the goods vide Section 70 of the Indian Contract Act.
26. Yes, vide Section 72 of the Indian Contract Act money paid under mistake can be recovered.
27. Yes, vide Section 72 of the Indian Contract Act.
28. No, vide Section 73 of the Indian Contract Act.
29. Yes, vide Section 128 of the Indian Contract Act, the liability of the surety is coextensive with that of the principal debtor.
30. Yes, vide Section 130 of the Indian Contract Act, notice revocation operates in respect of future transactions only.
31. No, as under Section 133 of the Indian Contract Act the surety has not agreed to the variation in the terms between A and B.
32. No, under Section 137 the surety is not discharged unless there is an agreement to the contrary.
33. No, under Section 143 the guarantee becomes invalid.
34. Rs. 10,000 each vide Section 147 of the Indian Contract Act.
35. Yes, vide Section 150 of the Indian Contract Act.
36. Yes, B is liable as the use of the car was not in the authorised manner.
37. Yes, under Section 163 any accretion to the goods bailed has to be made over to the bailor.
38. No, B has particular lien only in respect of one watch on which he has spent his labour and time vide Section 170 of the Indian Contract Act.
39. Yes, Under Section 189 of the Indian Contract Act, the Agent may do all that is necessary to protect the principal from loss.
40. Yes, vide Section 197.

41. No, vide Section 200.
42. No, because it is agency coupled with interest—Section 202.
43. Yes, there is implied revocation—Section 207.
44. Yes, under Section 212, an agent is expected to act with reasonable skill and diligence.
45. Yes, under Section 216, he may do so.
46. No, vide Section 224—the act is criminal.
47. A may sue either B or C or both—Section 233.
48. Yes, vide Section 237.

Suggested Readings:

(1) Indian Contract Act, 1872 — *Bare Act*

(2) A Manual of Mercantile Law — *M.C. Shukla*

(3) Law of Contract — *Avtar Singh*

STUDY III

SALE OF GOODS ACT, 1930

The law relating to sale of goods is contained in the Sale of Goods Act, 1930. It has to be read as part of the Indian Contract Act, 1872 [Sections 2(5) and (3)].

Contract of Sale of Goods

According to Section 4, a contract of sale of goods is a contract whereby the seller:

(i) transfers or agrees to transfer the property in goods,
(ii) to the buyer,
(iii) for a money consideration called the price.

It shows that the expression "contract of sale" includes both a sale where the seller transfers the ownership of the goods to the buyer, and an agreement to sell where the ownership of goods is to be transferred at a future time or subject to some conditions to be fulfilled later on.

The following are thus the essentials of a contract of sale of goods:

(i) *Bilateral contract:* It is a bilateral contract because the property in goods has to pass from one party to another. A person cannot buy the goods himself.
(ii) *Transfer of property:* The object of a contract of sale must be the transfer of property (meaning ownership) in goods from one person to another.
(iii) *Goods:* The subject matter must be some goods.
(iv) *Price or money consideration:* The goods must be sold for some price, where the goods are exchanged for goods it is barter, not sale.
(v) *All essential elements of a valid contract* must be present in a contract of sale.

Distinction between Sale and Agreement to Sell

The following points will bring out the distinction between sale and an agreement to sell:

(a) In a sale, the property in the goods sold passes to the buyer at the time of contract so that he becomes the owner of the goods. In an agreement to sell, the ownership does not pass to the buyer at the time of the contract, but it passes only when it becomes sale on the expiry of certain time or the fulfilment of some conditions subject to which the property in the goods is to be transferred.
(b) An agreement to sell is an executory contract, a sale is an executed contract.
(c) An agreement to sell is a contract pure and simple, but a sale is contract plus conveyance.
(d) If there is an agreement to sell and the goods are destroyed by accident, the loss falls on the seller. In a sale, the loss falls on the buyer, even though the goods are with the seller.
(e) If there is an agreement to sell and the seller commits a breach, the buyer

has only a personal remedy against the seller, namely, a claim for damages. But if there has been a sale, and the seller commits a breach by refusing to deliver the goods, the buyer has not only a personal remedy against him but also the other remedies which an owner has in respect of goods themselves such as a suit for conversion or detinue, etc.

Sale and Bailment

A "bailment" is a transaction under which goods are delivered by one person (the bailor) to another (the bailee) for some purpose, upon a contract that they be returned or disposed of as directed after the purpose is accomplished (Section 148 of the Indian Contact Act, 1872).

The property in the goods is not intended to and does not pass on delivery though it may sometimes be the intention of the parties that it should pass in due course. But where goods are delivered to another on terms which indicate that the property is to pass at once the contract must be one of sale and not bailment.

Sale and Contract for Work and Labour

The distinction between a "sale" and a "contract for work and labour" becomes important when question of passing of property arises for consideration.

However, these two are difficult to distinguish. The test generally applied is that if as a result of the contract, property in an article is transferred to one who had no property therein previously for a money consideration, it is a sale, where it is otherwise it is a contract for work and labour.

Sale and Hire Purchase Agreement

"Sale", is a contract by which property in goods passes from the seller to the buyer for a price.

A "hire purchase agreement" is basically a contract of hire, but in addition, it gives the hirer an option to purchase the goods at the end of the hiring period. Consequently, until the final payment, the hirer is merely a bailee of goods and ownership remains vested in the bailor. Under such a contract, the owner of goods delivers the goods to person who agrees to pay certain stipulated periodical payments as hire charges. Though the possession is with the hirer, the ownership of the goods remains with the original owner.

The essence of hire purchase agreement is that there is no agreement to buy, but only an option is given to the hirer to buy by paying all the instalments or put an end to the hiring and return the goods to the owner, at any time before the exercise of the option.

Since the hirer does not become owner of the goods until he has exercised his option to buy, he cannot pass any title even to an innocent and *bona fide* purchaser. The transaction of hire-purchase protects the owner of the goods against the insolvency of the buyer, for if the buyer becomes insolvent or fails to pay the instalments, he can take back the goods as owner. And if the hirer declines to take delivery of the goods, the remedy of the owner will be damages for non-hiring and not for rent for the period agreed.

It is important to note the difference between a hire purchase agreement and mere payment of the price by instalments because, the latter is a sale, only the

payment of price is to be made by instalments.

The distinction between the two is very important because, in a hire-purchase agreement the risk of loss or deterioration of the goods hired lies with the owner and the hirer will be absolved of any responsibility therefor, if he has taken reasonable care to protect the same as a bailee. But it is otherwise in the case of a sale where the price is to be paid in instalments.

Subject matter of Contract of Sale of Goods

Goods

The subject matter of the contract of sale is essentially goods. According to Section 2(7) of the Sale of Goods Act, "goods" means every kind of movable property other than actionable claims and money and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.

Actionable claims and money are not goods and cannot be brought and sold under this Act. Money means current money, i.e., the recognised currency in circulation in the country, but not old and rare coins which may be treated as goods. An actionable claim is what a person cannot make a present use of or enjoy, but what can be recovered by him by means of a suit or an action. Thus, a debt due to a man from another is an actionable claim and cannot be sold as goods, although it can be assigned. Under the provisions of the Transfer of Property Act, 1882, goodwill, trade marks, copyrights, patents are all goods, so is a ship. As regards water, gas, electricity, it is doubtful whether they are goods (*Rash Behari* v. *Emperor,* (1936) 41 C.W.N. 225; *M.B. Electric Supply Co. Ltd.* v. *State of Rajasthan,* AIR (1973) Raj. 132).

Goods may be (a) existing, (b) future, or (c) contingent. The existing goods may be (i) specific or generic, (ii) ascertained or unascertained.

Existing Goods

Existing goods are goods which are either owned or possessed by the seller at the time of the contract. Sale of goods possessed but not owned by the seller would be by an agent or pledgee.

Existing goods are specific goods which are identified and agreed upon at the time of the contract of sale. Ascertained goods are either specific goods at the time of the contract or are ascertained or identified to the contract later on i.e. made specific.

Generic or unascertained goods are goods which are not specifically identified but are indicated by description. If a merchant agrees to supply a radio set from his stock of radio sets, it is a contract of sale of unascertained goods because it is not known which set will be delivered. As soon as a particular set is separated or identified for delivery and the buyer has notice of it, the goods are ascertained and become specific goods.

Future Goods

Future goods are goods to be manufactured or produced or acquired by the seller after the making of the contract of sale. A agrees to sell all the mangoes which will be produced in his garden next season. This is an agreement for the sale of future goods. [Section 2(6)]

Contingent Goods

Where there is a contract for the sale of goods, the acquisition of which by the seller depends upon a contingency which may or may not happen—such goods are known as contigent goods. Contigent goods fall in the class of future goods. A agrees to sell a certain TV set provided he is able to get it from its present owner. This is an agreement to sell contigent goods. In such a case, if the contingency does not happen for no fault of the seller, he will not be liable for damages.

Actual sale can take place only of specific goods and property in goods passes from the seller to buyer at the time of the contract, provided the goods are in a deliverable state and the contract is unconditional.

There can be an agreement to sell only in respect of future or contingent goods.

Effect of Perishing of Goods

In a contract of sale of goods, the goods may perish before sale is complete. Such a stage may arise in the following cases:

(i) Goods perishing before making a contract

Where in a contract of sale of specific goods, the goods without the knowledge of the seller have, at the time of making the contract perished or become so damaged as no longer to answer to their description in the contract, the contract is void. This is based on the rule that mutual mistake of fact essential to the contract renders the contract void. (Section 7)

If the seller was aware of the destruction and still entered into the contract, he is estopped from disputing the contract. Moreover, perishing of goods not only includes loss by theft but also where the goods have lost their commercial value.

(ii) Goods perishing after agreement to sell

Where there is an agreement to sell specific goods, and subsequently the goods without any fault of any party perish or are so damaged as no longer to answer to their description in the agreement before the risk passes to the buyer, the agreement is thereby avoided. The provision applies only to sale of specific goods. If the sale is of unascertained goods, the perishing of the whole quantity of such goods in the possession of the seller will not relieve him of his obligation to deliver. (Section 8)

Price

No sale can take place without a price. Thus, if there is no valuable consideration to support a voluntary surrender of goods by the real owner to another person, the transaction is a gift, and is not governed by the Sale of Goods Act. Therefore, price, which is money consideration for the sale of goods, constitutes the essence for a contract of sale. It may be money actually paid or promised to be paid. If a consideration other than money is to be given, it is not a sale.

Modes of Fixing Price (Sections 9 and 10)

The price may be fixed:

(i) at the time of contract by the parties themselves, or
(ii) may be left to be determined by the course of dealings between the parties, or
(iii) may be left to be fixed in some way stipulated in the contract, or

(iv) may be left to be fixed by some third-party.

Where the contract states that the price is to be fixed by a third-party and such third-party fails to do so, the contract is void. But if the buyer has already taken the benefit of the goods, he must pay a reasonable price for them. If the third-party's failure to fix the price is due to the fault of the seller or buyer, then that party is liable for an action for damages.

Where nothing is said by the parties regarding price, the buyer must pay a reasonable price. What is a reasonable price is a question of fact dependent upon the circumstances of each particular case. Generally, the market price would be a reasonable price.

Conditions and Warranties (Sections 10-17)

The parties are at liberty to enter into a contract with any terms they please. As a rule, before a contract of sale is concluded, certain statements are made by the parties to each other. The statement may amount to a stipulation, forming part of the contract or a mere expression of opinion which is not part of the contract. If it is a statement by the seller on the reliance of which the buyer makes the contract, it will amount to a stipulation. If it is a mere commendation by the seller of his goods it does not amount to a stipulation and does not give the right of action.

The stipulation may either be a condition or a warranty. Section 12 draws a clear distinction between a condition and a warranty. Whether a stipulation is a condition or only a warranty is a matter of substance rather than the form of the words used. A stipulation may be a condition though called a warranty and vice versa.

Conditions

If the stipulation forms the very basis of the contract or is essential to the main purpose of the contract, it is a condition. The breach of the condition gives the aggrieved party a right to treat the contract as repudiated. Thus, if the seller fails to fulfil a condition, the buyer may treat the contract as repudiated, refuse the goods and, if he has already paid for them, recover the price. He can also claim damages for the breach of contract.

Warranties

If the stipulation is collateral to the main purpose of the contract, i.e., is a subsidiary promise, it is a warranty. The effect of a breach of a warranty is that the aggrieved party cannot repudiate the contract but can only claim damages. Thus, if the seller does not fulfil a warranty, the buyer must accept the goods and claim damages for breach of warranty.

Section 11 states that the stipulation as to time of payment are not to be deemed conditions (and hence not to be of the essence of a contract of sale) unless such an intention appears from the contract. Whether any other stipulation as to time (e.g., time of delivery) is of the essence of the contract or not depends on the terms of the contract.

When condition sinks to the level of warranty

In some cases a condition sinks or descends to the level of a warranty. The first

two cases depend upon the will of the buyer, but the third is compulsory and acts as estoppel against him.

(a) A condition will become a warranty where the buyer waives the condition; or

(b) A condition will sink to the level of a warranty where the buyer treats the breach of condition as a breach of warranty; or

(c) Where the contract is indivisible and the buyer has accepted the goods or part thereof, the breach of condition can only be treated as breach of warranty. The buyer can only claim damages and cannot reject the goods or treat the contract as repudiated.

Sometimes the seller may be excused by law from fulfilling any condition or warranty and the buyer will not then have a remedy in damages.

Implied Warranties/Conditions

Even where no definite representations have been made, the law implies certain representations as having been made which may be warranties or conditions. An express warranty or condition does not negative an implied warranty or condition unless inconsistent therewith.

There are two implied warranties:

Implied Warranties [Section 14(b), 14(c) and 16(3)]

(a) *Implied warranty of quiet possession:* If the circumstances of the contract are such as there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods.

(b) *Implied warranty against encumbrances:* There is a further warranty that the goods are not subject to any right in favour of a third-party, or the buyer's possession shall not be disturbed by reason of the existence of encumbrances. This means that if the buyer is required to, and does discharge the amount of the encumbrance, there is breach of warranty, and he is entitled to claim damages from the seller.

Implied Conditions [Sections 14(a), 15(1), (2), 16(1) and Proviso 16(2), and Proviso 16(3) and 12(b) and 12(c)].

Different implied conditions apply under different types of contracts of sale of goods, such as sale by description, or sale by sample, or sale by description as well as sample. The condition, as to title to goods applies to all types of contracts, subject to that there is apparently no other intention.

Implied Conditions as to title

There is an implied condition that the seller, in an actual sale, has the right to sell the goods, and, in an agreement to sell, he will have a right to sell the goods at the time when property is to pass. As a result, if the title of the seller turns out to be defective, the buyer is entitled to reject the goods and can recover the full price paid by him.

In *Rowland* v. *Divall* (1923) 2 K.B. 500, 'A' had bought a second hand motor car from 'B' and paid for it. After he had used it for six months, he was deprived of it because the seller had no title to it. It was held that 'B' had broken the condition as to title and 'A' was therefore, entitled to recover the purchase money from 'B'

Implied conditions under a sale by description

In a sale by description there are the following implied conditions:

(a) *Goods must correspond with description:* It is provided under Section 15 of the Act that when there is a sale of goods by description, there is an implied condition that the goods shall correspond with description.

In a sale by description, the buyer relies for his information on the description of the goods given by the seller, e.g. in the contract or in the preliminary negotiations.

Where 'A' buys goods which he has not seen, it must be sale by description, e.g., where he buys a 'new Fiat car' from 'B' and the car is not new, he can reject the car.

Even if the buyer has seen the goods, the goods must be in accordance with the description (*Beale* v. *Taylor* (1967) All E.R. 253).

(b) *Goods must also be of merchantable quality:* If they are bought by description from dealer of goods of that description. [Section 16(2)]

Merchantable quality means that the goods must be such as would be acceptable to a reasonable person, having regard to prevailing conditions. They are not merchantable if they have defects which make them unfit for ordinary use, or are such that a reasonable person knowing of their condition would not buy them. 'P' bought black yarn from 'D' and, when delivered, found it damaged by the white ants. The condition of merchantability was broken.

But, if the buyer has examined the goods, there is no implied condition as regards defects which such examination ought to have revealed. If, however, examination by the buyer does not reveal the defect and he approves and accepts the goods, but when put to work, the goods are found to be defective, there is a breach of condition of merchantable quality.

The buyer is given a right to examine the goods before accepting them. But a mere opportunity without an actual examination, however, cursory, would not suffice to deprive him of this right.

(c) *Condition as to wholesomeness:* The provisions, (i.e., eatables) supplied must not only answer the description, but they must also be merchantable and wholesome or sound. 'F' bought milk from 'A' and the milk contained typhoid germs. 'F's wife became infected and died. 'A' was liable for damages. Again, 'C' bought a bun at 'M's bakery, and broke one of his teeth by biting on a stone present in the bun. 'M' was held liable.

(d) *Condition as to quality or fitness for a particular purpose:* Ordinarily, in a contract of sale, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied.

But there is an implied condition that the goods are reasonably fit for the purpose for which they are required if:

(i) the buyer expressly or by implication makes known to the seller the particular purpose for which the goods are required, so as to show that he relies on the seller's skill and judgement, and

(ii) the goods are of a description which it is in the course of the seller's business to supply (whether he is the manufacturer or producer or not). There is no such condition if the goods are bought under a patent or trade name.

In *Priest* v. *Last* (1903) 2 K.B. 148, a hot water bottle was bought by the plaintiff, a draper, who could not be expected to have special skill knowledge with regard to hot water bottles, from a chemist, who sold such articles stating that the bottle will not

stand boiling water but was intended to hold hot water. While being used by the plaintiff's wife, the bottle bursted and injured her. *Held,* the seller was responsible for damages as the bottle was not fit for use as a hot water bottle.

In *Grant* v. *Australian Knitting Mills* (1936) 70 MLJ 513, 'G' a doctor purchased woollen underpants from 'M' a retailer whose business was to sell goods of that description. After wearing the underpants, 'G' developed some skin diseases. *Held,* the goods were not fit for their only use and 'G' was entitled to avoid the contract and claim damages.

Implied conditions under a sale by sample (Section 17)

In a contract of sale by sample:

(a) there is an implied condition that the bulk shall correspond with the sample in quality;

(b) there is another implied condition that the buyer shall have a reasonable opportunity of comparing the bulk with the sample;

(c) it is further an implied condition of merchantability, as regards latent or hidden defects in the goods which would not be apparent on reasonable examination of the sample. "Worsted coating" quality equal to sample was sold to tailors, the cloth was found to have a defect in the fixture rendering the same unfit for stitching into coats. The seller was held liable even though the same defect existed in the sample, which was examined.

Implied conditions in sale by sample as well as by description

In a sale by sample as well as by description, the goods supplied must correspond both with the samples as well as with the description. Thus, in *Nichol* v. *Godis* (1854) 158 E.R. 426, there was a sale of "foreign refined rape-oil having warranty only equal to sample". The oil tendered was the same as the sample, but it was not "foreign refined rape-oil" having a mixture of it and other oil. It was held that the seller was liable, and the buyer could refuse to accept.

Implied Warranties

Implied warranties are those which the law presumes to have been incorporated in the contract of sale inspite of the fact that the parties have not expressly included them in a contract of sale. Subject to the contract to the contrary, following are the implied warranties in a contract of sale:

(i) *Warranty as to quiet possession:* Section 14(b) of the Sale of Goods Act provides that there is an implied warranty that the buyer shall have and enjoy quiet possession of goods. If the buyer's possession is disturbed by anyone having superior title than that of the seller, the buyer is entitled to hold the seller liable for breach of warranty.

(ii) *Warranty as to freedom from encumbrances:* Section 14(c) states that in a contract of sale, there is an implied warranty that the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time when the contract is made. But if the buyer is aware of any encumbrance on the goods at the time of entering into the contract, he will not be entitled to any compensation from the seller for discharging the encumbrance.

(iii) *Warranty to disclose dangerous nature of goods*: If the goods are inherently dangerous or likely to be dangerous and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger.

(iv) *Warranties implied by the custom or usage of trade*: Section 16(3) provides that an implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade.

Doctrine of *Caveat Emptor*

The term *"caveat emptor"* is a Latin word which means "let the buyer beware". This principle states that it is for the buyer to satisfy himself that the goods which he is purchasing are of the quality which he requires. If he buys goods for a particular purpose, he must satisfy himself that they are fit for that purpose. The doctrine of *caveat emptor* is embodied in Section 16 of the Act which states that "subject to the provisions of this Act and of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale". In simple words, it is not the seller's duty to give to the buyer the goods which are fit for a suitable purpose of the buyer. If he makes a wrong selection, he cannot blame the seller if the goods turn out to be defective or do not serve his purpose. The principle was applied in the case of *Ward* v. *Hobbs,* (1878) 4 A.C. 13, where certain pigs were sold by auction and no warranty was given by seller in respect of any fault or error of description. The buyer paid the price for healthy pigs. But they were ill and all but one died of typhoid fever. They also infected some of the buyer's own pigs. It was held that there was no implied condition or warranty that the pigs were of good health. It was the buyer's duty to satisfy himself regarding the health of the pigs.

Exceptions: Section 16 lays down the following exceptions to the doctrine of *Caveat Emptor:*

(1) Where the seller makes a false representation and the buyer relies on it.

(2) When the seller actively conceals a defect in the goods which is not visible on a reasonable examination of the same.

(3) When the buyer, relying upon the skill and judgement of the seller, has expressly or impliedly communicated to him the purpose for which the goods are required.

(4) Where goods are bought by description from a seller who deals in goods of that description.

Passing of Property or Transfer of Ownership (Sections 18-20)

The sole purpose of a sale is the transfer of ownership of goods from the seller to the buyer. It is important to know the precise moment of time at which the property in the goods passes from the seller to the buyer for the following reasons:

(a) The general rule is that risk follows the ownership, whether the delivery has been made or not. If the goods are lost or damaged by accident or otherwise, then, subject to certain exceptions, the loss falls on the owner of the goods at the time they are lost or damaged.

(b) When there is a danger of the goods being damaged by the action of third parties, it is generally the owner who can take action.

(c) The rights of third parties may depend upon the passing of the property if the buyer resells the goods to a third-party, the third-party will only obtain a good title if the property in the goods has passed to the buyer before or at the time of the resale. Similarly, if the seller, in breach of his contract with the buyer, attempts to sell the goods to a third party in the goods, has not passed to the buyer, e.g., where there is only an agreement to sell.

(d) In case of insolvency of either the seller or the buyer, it is necessary to know whether the goods can be taken over by the official assignee or the official receiver. It will depend upon whether the property in the goods was with the party adjudged insolvent.

Thus in this context, ownership and possession are two distinct concepts and these two can at times remain separately with two different persons.

Passing of property in specific goods

In a sale of specific or ascertained goods, the property in them passes to the buyer as and when the parties intended to pass. The intention must be gathered from the terms of the contract, the conduct of the parties and the circumstances of the case.

Unless a contrary intention appears, the following rules are applicable for ascertaining the intention of the parties:

(a) Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made. Deliverable state means such a state that the buyer would be bound to take delivery of the goods. The fact that the time of delivery or the time of payment is postponed does not prevent the property from passing at once. (Section 20)

(b) Where there is a contract for the sale of specific goods not in a deliverable state, i.e., the seller has to do something to the goods to put them in a deliverable state, the property does not pass until that thing is done and the buyer has notice of it. (Section 21)

A certain quantity of oil was brought. The oil was to be filled into casks by the seller and then taken away by the buyer. Some casks were filled in the presence of buyer but, before the remainder could be filled, a fire broke out and the entire quantity of oil was destroyed, *Held,* the buyer must bear the loss of the oil which was put into the casks (i.e., put in deliverable state) and the seller must bear the loss of the remainder (*Rugg* v. *Minett* (1809) 11 East 210).

(c) Where there is a sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do something with reference to the goods for the purpose of ascertaining the price, the property to the goods for the purpose of ascertaining the price, does not pass until such act or thing is done and the buyer has notice of it. (Section 22)

(d) When goods are delivered to the buyer “on approval” or “on sale of return” or other similar terms the property therein passes to the buyer:

(i) when he signifies his approval or acceptance to the seller, or does any other act adopting the transaction;

(ii) if he does not signify his approval or acceptance but retains the goods without giving notice of rejection, in such a case—(a) if a time has been fixed for the return of the goods, on the expiration of such time; and (b) if no time has been fixed, on the expiration of a reasonable time.

Ownership in unascertained goods

The property in unascertained or future goods does not pass until the goods are ascertained.

Unascertained goods are goods defined by description only, for example, 100 quintals of wheat; and not goods identified and agreed upon when the contract is made.

Unless a different intention appears, the following rules are applicable for ascertaining the intention of the parties in regard to passing of property in respect of such goods:

(a) The property in unascertained or future goods sold by description passes to the buyer when goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller. Such assent may be expressed or implied and may be given either before or after the appropriation is made. (Section 23)

(b) If there is a sale of a quantity of goods out of a large quantity, for example, 50 quintals of rice out of a heap in B's godown, the property will pass on the appropriation of the specified quantity by one party with the assent of the other.

(c) Delivery by the seller of the goods to a carrier or other buyer for the purpose of transmission to the buyer in pursuance of the contact is an appropriation sufficient to pass the property in the goods.

(d) The property in goods, whether specific or unascertained, does not pass if the seller reserves the right of disposal of the goods. Apart from an express reservation of the right of disposal, the seller is deemed to reserve the right of disposal in the following two cases:

    (i) where goods are shipped or delivered to a railway administration for carriage by railway and by the bill of lading or railway receipt, the goods are deliverable to the order of the seller or his agent.

    (ii) when the seller sends the bill of exchange for the price of the goods to the buyer for this acceptance, together with the bill of lading, the property in the goods does not pass to the buyer unless he accepts the bill of exchange.

Passing of Risk (Section 26)

The general rule is that goods remain at the seller's risk until the ownership is transferred to the buyer. After the ownership has passed to the buyer, the goods are at the buyer's risk whether the delivery has been made or not. For example, 'A' buys goods of 'B' and property has passed from 'B' to 'A'; but the goods remain in 'B's warehouse and the price is unpaid. Before delivery, 'B's warehouse is burnt down for no fault of 'B' and the goods are destroyed. 'A' must pay 'B' the price of the goods, as he was the owner. The rule is *resperit demino*- the loss falls on the owner.

But the parties may agree that risk will pass at the time different from the time when ownership passed. For example, the seller may agree to be responsible for the goods even after the ownership is passed to the buyer or *vice versa.*

In *Consolidated Coffee Ltd.* v. *Coffee Board,* (1980 3 SCC 358), one of the terms adopted by coffee board for auction of coffee was the property in the coffee knocked down to a bidder would not pass until the payment of price and in the meantime the goods would remain with the seller but at the risk of the buyer, In such cases, risk and property passes on at different stages.

In *Multanmal Champalal* v. *Shah & Co., AIR (1970) Mysore 106,* goods were despatched by the seller from Bombay to Bellary through a public carrier. According to the terms of the contract, the goods were to remain the property of the seller till the price was paid though the risk was to pass to the buyer when they were delivered to public carrier for despatch. When the goods were subsequently lost before the payment of the price (and the consequent to the passing of the property to the buyer), the Court held that the loss was to be borne by the buyer.

It was further held in the same case that the buyer was at fault in delaying delivery unreasonably and therefore on that ground also he was liable for the loss, because such loss would not have arisen but for such delay.

Thus, where delivery has been delayed through the fault of either the buyer or the seller, in such a case, the goods are at the risk of the party at fault as regards any loss which might not have occurred but for such fault.

Transfer of Title by Person not the Owner (Section 27-30)

The general rule is that only the owner of goods can sell the goods. Conversely, the sale of an article by a person who is not or who has not the authority of the owner, gives no title to the buyer. The rule is expressed by the maxim; *"Nemo Dat Quod Non Habet"* i.e. no one can pass a better title than he himself has. As applied to the sale of goods, the rule means that a seller of goods cannot give a better title to the buyer than he himself possess. Thus, even a *bona fide* buyer who buys stolen goods from a thief or from a transfree from such a thief can get no valid title to them, since the thief has no title, nor could he give one to any transferee.

Example:

1. A, the hirer of goods under a hire purchase agreement, sells them to B, then B, though a *bona fide* purchaser, does not acquire the property in the goods. At most he can acquire such an interest as the hirer had.
2. A finds a ring of B and sells it to a third person who purchases it for value and in good faith. The true owner, i.e. B can recover from that person, for A having no title to the ring could pass none the better.

Exception to the General Rule

The Act while recognizing the general rule that no one can give a better title than he himself has, laid down important exceptions to it. Under the exceptions the buyer gets a better title to the goods than the seller himself. These exceptions are given below:

(a) *Sale by a mercantile agent:* A buyer will get a good title if he buys in good faith from a mercantile agent who is in possession either of the goods or documents of title to the goods with the consent of the owner, and who sells the goods in the ordinary course of his business.

(b) *Sale by a co-owner:* A buyer who buys in good faith from one of the several joint owners who is in sole possession of the goods with the permission of his co-owners will get good title to the goods.

(c) *Sale by a person in possession under a voidable contract:* A buyer buys in good faith from a person in possession of goods under a contract which is voidable, but has not been rescinded at the time of the sale.

(d) *Sale by seller in possession after sale:* Where a seller, after having sold the goods, continues or is in possession of the goods or of the documents of title to the goods and again sells them by himself or through his mercantile agent to a person who buys in good faith and without notice of the previous sale, such a buyer gets a good title to the goods.

(e) *Sale by buyer in possession:* If a person has brought or agreed to buy goods obtains, with the seller's consent, possession of the goods or of the documents of title to them, any sale by him or by his mercantile agent to a buyer who takes in good faith without notice of any lien or other claim of the original seller against the goods, will give a good title to the buyer. In any of the above cases, if the transfer is by way of pledge or pawn only, it will be valid as a pledge or pawn.

(f) *Estoppel:* If the true owner stands by and allows an innocent buyer to pay over money to a third-party, who professes to have the right to sell an article, the true owner will be estopped from denying the third-party's right to sell.

(g) *Sale by an unpaid seller:* Where an unpaid seller has exercised his right of lien or stoppage in transit and is in possession of the goods, he may resell them and the second buyer will get absolute right to the goods.

(h) *Sale by person under other laws:* A pawnee, on default of the pawnee to repay, has a right to sell the goods, pawned and the buyer gets a good title to the goods. The finder of lost goods can also sell under certain circumstances. The Official Assignee or Official Receiver, Liquidator, Officers of Court selling under a decree, Executors, and Administrators, all these persons are not owners, but they can convey better title than they have.

12. Performance of the Contract of Sale

It is the duty of the seller and buyer that the contract is performed. The duty of the seller is to deliver the goods and that of the buyer to accept the goods and pay for them in accordance with the contract of sale.

Unless otherwise agreed, payment of the price and the delivery of the goods and concurrent conditions, i.e., they both take place at the same time as in a cash sale over a shop counter.

Delivery (Sections 33-39)

Delivery is the voluntary transfer of possession from one person to another. Delivery may be actual, constructive or symbolic. *Actual or physical delivery* takes place where the goods are handed over by the seller to the buyer or his agent authorised to take possession of the goods. *Constructive* delivery takes place when the person in possession of the goods acknowledges that he holds the goods on behalf of and at the disposal of the buyer. For example, where the seller, after having sold the goods, may hold them as bailee for the buyer, there is constructive delivery.

Symbolic delivery is made by indicating or giving a symbol. Here the goods themselves are not delivered, but the "means of obtaining possession" of goods is delivered, e.g, by delivering the key of the warehouse where the goods are stored, bill of lading which will entitle the holder to receive the goods on the arrival of the ship.

Rules as to delivery

The following rules apply regarding delivery of goods:

(a) Delivery should have the effect of putting the buyer in possession.

(b) The seller must deliver the goods according to the contract.

(c) The seller is to deliver the goods when the buyer applies for delivery; it is the duty of the buyer to claim delivery.

(d) Where the goods at the time of the sale are in the possession of a third person, there will be delivery only when that person acknowledges to the buyer that he holds the goods on his behalf.

(e) The seller should tender delivery so that the buyer can take the goods. It is no duty of the seller to send or carry the goods to the buyer unless the contract so provides. But the goods must be in a deliverable state at the time of delivery or tender of delivery. If by the contract the seller is bound to send the goods to the buyer, but no time is fixed, the seller is bound to send them within a reasonable time.

(f) The place of delivery is usually stated in the contract. Where it is so stated, the goods must be delivered at the specified place during working hours on a working day. Where no place is mentioned, the goods are to be delivered at a place at which they happen to be at the time of the contract of sale and if not then in existence they are to be delivered at the place at which they are manufactured or produced.

(g) The seller has to bear the cost of delivery unless the contract otherwise provides. While the cost of obtaining delivery is said to be of the buyer, the cost of the putting the goods into deliverable state must be borne by the seller. In other words, in the absence of an agreement to the contrary, the expenses of and incidental to making delivery of the goods must be borne by the seller, the expenses of and incidental to receiving delivery must be borne by the buyer.

(h) If the goods are to be delivered at a place other than where they are, the risk of deterioration in transit will, unless otherwise agreed, be borne by the buyer.

(i) Unless otherwise agreed, the buyer is not bound to accept delivery in instalments.

Acceptance of Goods by the Buyer

Acceptance of the goods by the buyer takes place when the buyer:

(a) intimates to the seller that he has accepted the goods; or

(b) retains the goods, after the lapse of a reasonable time without intimating to the seller that he has rejected them; or

(c) does any act on the goods which is inconsistent with the ownership of the seller, e.g., pledges or resells. If the seller sends the buyer a larger or smaller quantity of goods than ordered, the buyer may:

(a) reject the whole; or

(b) accept the whole; or

(c) accept the quantity be ordered and reject the rest.

If the seller delivers with the goods ordered, goods of a wrong description, the buyer may accept the goods ordered and reject the rest, or reject the whole.

Where the buyer rightly rejects the goods, he is not bound to return the rejected goods to the seller. It is sufficient if he intimates the seller that he refuses to accept them. In that case, the seller has to remove them.

Instalment Deliveries

When there is a contract for the sale of goods to be delivered by stated instalments which are to be separately paid for, and either the buyer or the seller commits a breach of contract, it depends on the terms of the contract whether the breach is a repudiation of the whole contract or a severable breach merely giving right to claim for damages.

Suits for Breach of Contract

Where the property in the goods has passed to the buyer, the seller may sue him for the price.

Where the price is payable on a certain day regardless of delivery, the seller may sue for the price, if it is not paid on that day, although the property in the goods has not passed.

Where the buyer wrongfully neglects or refuses to accept the goods and pay for them, the seller may sue the buyer for damages for non-acceptance.

Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue him for damages for non-delivery.

Where there is a breach of warranty or where the buyer elects or is compelled to treat the breach of condition as a breach of warranty, the buyer cannot reject the goods. He can set breach of warranty in extinction or dimunition of the price payable by him and if loss suffered by him is more than the price he may sue for the damages.

If the buyer has paid the price and the goods are not delivered, the buyer can sue the seller for the recovery of the amount paid. In appropriate cases the buyer can also get an order from the court that the specific goods ought to be delivered.

Anticipatory Breach

Where either party to a contract of sale repudiates the contract before the date of delivery, the other party may either treat the contract as still subsisting and wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach.

In case the contract is treated as still subsisting it would be for the benefit of both the parties and the party who had originally repudiated will not be deprived of:

(a) his right of performance on the due date in spite of his prior repudiation; or

(b) his rights to set up any defence for non-performance which might have actually arisen after the date of the prior repudiation.

Measure of Damages

The Act does not specifically provide for rules as regards the measure of damages except by stating that nothing in the Act shall affect the right of the seller or

the buyer to recover interest or special damages in any case were by law they are entitled to the same. The inference is that the rules laid down in Section 73 of the Indian Contract Act will apply.

Unpaid Seller (Sections 45-54)

Who is an unpaid seller? (Section 45)

The seller of goods is deemed to be unpaid seller:

(a) When the whole of the price has not been paid or tendered; or

(b) When a conditional payment was made by a bill of exchange or other negotiable instrument, and the instrument has been dishonoured.

Rights of an Unpaid Seller against the Goods

An unpaid seller's right against the goods are:

(a) A lien or right of retention
(b) The right of stoppage in transit.
(c) The right of resale.
(d) The right to withhold delivery.

(a) *Right of Lien* (Sections 47-49 and 54) An unpaid seller in possession of goods sold, may exercise his lien on the goods, i.e., keep the goods in his possession and refuse to deliver them to the buyer until the fulfilment or tender of the price in cases where:

(i) the goods have been sold without stipulation as to credit; or
(ii) the goods have been sold on credit, but the term of credit has expired; or
(iii) the buyer becomes insolvent.

The lien depends on physical possession. The seller's lien is *possessory lien,* so that it can be exercised only so long as the seller is in possession of the goods. It can only be exercised for the non-payment of the price and not for any other charges.

A lien is lost—

(i) When the seller delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer, without reserving the right of disposal of the goods;
(ii) When the buyer or his agent lawfully obtains possession of the goods;
(iii) By waiver of his lien by the unpaid seller.

(b) *Stoppage in transit* (Sections 50-52) The right of stoppage in transit is a right of stopping the goods while they are in transit, resuming possession of them and retaining possession until payment of the price.

The right to stop goods is available to an unpaid seller

(i) when the buyer becomes insolvent; and
(ii) the goods are in transit.

The buyer is insolvent if he has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due. It is not necessary that he has actually been declared insolvent by the court.

The goods are in transit from the time they are delivered to a carrier or other bailee like a wharfinger or warehousekeeper for the purpose of transmission to the buyer and until the buyer takes delivery of them.

The transit comes to an end in the following cases:

(i) If the buyer obtains delivery before the arrival of the goods at their destination;

(ii) If, after the arrival of the goods at their destination, the carrier acknowledges to the buyer that he holds the goods on his behalf, even if further destination of the goods is indicated by the buyer;

(iii) If the carrier wrongfully refuses to deliver the goods to the buyer.

If the goods are rejected by the buyer and the carrier or other bailee holds them, the transit will be deemed to continue even if the seller has refused to receive them back.

The right to stop in transit may be exercised by the unpaid seller either by taking actual possession of the goods or by giving notice of the seller's claim to the carrier or other person having control of the goods. On notice being given to the carrier, he must redeliver the goods to the seller who must pay the expenses of the redelivery.

The seller's right of lien or stoppage in transit is not affected by any sale on the part of the buyer unless the seller has assented to it. A transfer, however, of the bill of lading or other document of seller to a bona fide purchaser for value is valid against the seller's right.

(c) *Right of re-sale* (Section 54): The unpaid seller may re-sell:

(i) where the goods are perishable;

(ii) where the right is expressly reserved in the contract;

(iii) where in exercise of right of lien or stoppage in transit, the seller gives notice to the buyer of his intention to re-sell, and the buyer, does not pay or tender the price within a reasonable time.

If on a re-sale, there is a deficiency between the price due and amount realised, he is entitled to recover it from the buyer. If there is a surplus, he can keep it. He will not have these rights if he has not given any notice and he will have to pay the buyer profit, if any, on the resale.

(d) *Rights to withhold delivery:* If the property in the goods has passed, the unpaid seller has right as described above. If, however, the property has not passed, the unpaid seller has a right of withholding delivery similar to and co-extensive with his rights of lien and stoppage in transit.

Rights of an unpaid seller against the buyer (Sections 55 and 56)

An unpaid seller may sue the buyer for the price of the goods in case of breach of contract where the property in the goods has passed to the buyer or he has wrongfully refused to pay the price according to the terms of the contract.

The seller may sue the buyer even if the property in the goods has not passed where the price is payable on a certain day.

Under Section 56, the seller may sue the buyer for damages or breach of contract where the buyer wrongfully neglects or refuses to accept and pay for the

goods.

Thus an unpaid sellers rights against the buyer personally are:

(a) a suit for the price.

(b) a suit for damages.

Auction Sales (Section 64)

A sale by auction is a public sale where goods are offered to be taken by bidders. It is a proceeding at which people are invited to complete for the purchase of property by successive offer of advancing sums.

Section 64 lays down the rules regulating auction sales. Where goods are put up for sale in lots, each, lot is *prima facie* deemed to be the subject of a separate contract of sale. The sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner. Until such announcement is made, any bidder may retract his bid.

A right to bid may be reserved expressly by or on behalf of the seller. Where such right is expressly so reserved, the seller or any other person on his behalf may bid at the auction. Where the sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person. Any sale in contravention of this rule may be treated as fraudulent by the buyer. The sale may be notified to be subject to a reserved price. Where there is such notification, every bid is a conditional offer subject to its being up to the reserve price. Where an auctioneer inadvertently knocks down to a bidder who has bid less than the reserved price, there is no contract of sale. If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

Trading Contracts Involving Rail or Sea Transit

In the case of a contract for the sale of goods which are to be shipped by sea a number of conditions are attached by the parties or by custom and practice of merchants. Some of the important types of such contracts are given below:

(a) *F.O.B.(Free on Board):* Under an F.O.B. contract, it is the duty of the seller to put the goods on board a ship at his own expenses. The property in goods passes to the buyer only after the goods have been put on board the ship, and they are at buyer's risk as soon as they are put on board the ship, usually named by the buyer. The seller must notify the buyer immediately that the goods have been delivered on board, so that the buyer may insure them. If he fails to do so the goods shall be deemed to be at seller's risk during such sea transit.

(b) *F.O.R. (Free on Rail):* Similar position prevails in these contracts as in the case of F.O.B. contracts.

(c) *C.I.F. or C.F.I. (Cost Insurance and Freight):* A CIF contract is a contract for the sale of insured goods lost or not lost to be implemented by transfer of proper documents.

In such types of contracts, the seller not only bears all the expenses of putting the goods on board the ship as in an F.O.B. contract, but also to bear

the freight and insurance charges. He will arrange for an insurance of the goods for the benefit of the buyer. On the tender of documents, the buyer is required to pay and then take delivery. He has a right to reject the goods if they are not according to the contract.

(d) *Ex-Ship:* Here the seller is bound to arrange the shipment of the goods to the port of destination, and to such further inland destination as the buyer may stipulate. The buyer is not bound to pay until the goods are ready for unloading from the ship and all freight charges paid. The goods travel at the seller's risk, but he is not bound to insure them.

SELF-TEST QUESTIONS

1. Define contract of sale of goods and distinguish between sale and agreement to sell and hire purchase agreement.
2. Write short notes on:
   (i) Existing goods,
   (ii) Future goods,
   (iii) Contingent goods.
3. Define and distinguish between a condition and a warranty. Under what circumstances a breach of condition is to be treated as a breach of warranty.
4. Why it is important to know the time of passing of property? What are the rights of an unpaid seller against the goods and against the buyer?
5. Explain the following:
   (i) Doctrine of *Caveat emptor.*
   (ii) Doctrine of *'Nemo dat quod non habet'.*
6. Discuss the rights of an unpaid seller.
7. State with reasons whether the purchaser will acquire a good title to the goods in the following cases:
   (a) A and B are co-owners of a T.V. while the T.V. is in possession of B. A secretary takes it away and sells it to C, a bonafide purchaser for value.
   (b) X by way of undue influence buys a car from Y at a very low price and sells it to Z, an innocent purchaser.

Suggested Readings:

(1) The Sale of Goods Act, 1930 — *Bare Act*
(2) Manual of Merchantile Law — *M.C. Shukla*
(3) The Indian Contract Act, Sale of Goods Act and Partnership Act — *T.R. Desai Revised by K.H. Kaji, S.C. Sarkar & Sons, Calcutta*

STUDY IV

NEGOTIABLE INSTRUMENTS ACT, 1881

Definition of a Negotiable Instrument

The law relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881. It is an Act to define and amend the law relating to promissory notes, bills of exchange and cheques.

The Act does not affect the custom or local usage relating to an instrument in oriental language i.e., a Hundi.

The term *"negotiable instrument"* means a document transferable from one person to another. However the Act has not defined the term. It merely says that "A negotiable instrument" means a promissory note, bill of exchange or cheque payable either to order or to bearer. [Section 13(1)]

A negotiable instrument may be defined as "an instrument, the property in which is acquired by anyone who takes it bona fide, and for value, notwithstanding any defect of title in the person from whom he took it, from which it follows that an instrument cannot be negotiable unless it is such and in such a state that the true owner could transfer the contract or engagement contained therein by simple delivery of instrument" (*Willis—The Law of Negotiable Securities, Page 6*).

According to this definition the following are the conditions of negotiability:

(i) The instrument should be freely transferable. An instrument cannot be negotiable unless it is such and in such state that the true owner could transfer by simple delivery or endorsement and delivery.

(ii) The person who takes it for value and in good faith is not affected by the defect in the title of the transferor.

(iii) Such a person can sue upon the instrument in his own name.

Negotiability involves two elements namely, transferability free from equities and transferability by delivery or endorsement (Mookerjee J. In *Tailors Priya* v. *Gulab Chand*, AIR 1965 Cal).

But the Act recognises only three types of instruments viz., a Promissory Note, a Bill of Exchange and a Cheque as negotiable instruments. However, it does not mean that other instruments are not negotiable instruments provided that they satisfy the following conditions of negotiability:

1. The instrument should be freely transferable by the custom of trade. Transferability may be by (i) delivery or (ii) endorsement and delivery.
2. The person who obtains it in good faith and for consideration gets it free from all defects and can sue upon it in his own name.
3. The holder has the right to transfer. The negotiability continues till the maturity.

Effect of Negotiability

The general principle of law relating to transfer of property is that no one can pass a better title than he himself has *(nemodat quad non-habet).* The exceptions to this general rule arise by virtue of statute or by a custom. A negotiable instrument is one such exception which is originally a creation of mercantile custom.

Thus a *bona fide* transferee of negotiable instrument for consideration without notice of any defect of title, acquires the instrument free of any defect, i.e., he acquires a better title than that of the transferor.

Important Characteristics of Negotiable Instruments

Following are the important characteristics of negotiable instruments:

(1) The holder of the instrument is presumed to be the owner of the property contained in it.

(2) They are freely transferable.

(3) A holder in due course gets the instrument free from all defects of title of any previous holder.

(4) The holder in due course is entitled to sue on the instrument in his own name.

(5) The instrument is transferable till maturity and in case of cheques till it becomes stale (on the expiry of 6 months from the date of issue).

(6) Certain equal presumptions are applicable to all negotiable instruments unless the contrary is proved.

Classification of Negotiable Instruments

The negotiable instruments may be classified as under:

(1) Bearer Instruments

A promissory note, bill of exchange or cheque is payable to bearer when (i) it is expressed to be so payable, or (ii) the only or last endorsement on the instrument is an endorsement in blank. A person who is a holder of a bearer instrument can obtain the payment of the instrument.

(2) Order Instruments

A promissory note, bill of exchange or cheque is payable to order (i) which is expressed to be so payable; or (ii) which is expressed to be payable to a particular person, and does not contain any words prohibiting transfer or indicating an intention that it shall not be transferable.

(3) Inland Instruments (Section 11)

A promissory note, bill of exchange or cheque drawn or made in India, and made payable, or drawn upon any person, resident in India shall be deemed to be an inland instrument. Since a promissory note is not drawn on any person, an inland promissory note is one which is made payable in India. Subject to this exception, an inland instrument is one which is either:

(i) drawn and made payable in India, or

(ii) drawn in India upon some persons resident therein, even though it is made payable in a foreign country.

(4) Foreign Instruments

An instrument which is not an inland instrument, is deemed to be a foreign instrument. The essentials of a foreign instrument include that:

(i) it must be drawn outside India and made payable outside or inside India; or

(ii) it must be drawn in India and made payable outside India and drawn on a person resident outside India.

(5) Demand Instruments (Section 19)

A promissory note or a bill of exchange in which no time for payment is specified is an instrument payable on demand.

(6) Time Instruments

Time instruments are those which are payable at sometime in the future. Therefore, a promissory note or a bill of exchange payable after a fixed period, or after sight, or on specified day, or on the happening of an event which is certain to happen, is known as a time instrument. The expression “after sight” in a promissory note means that the payment cannot be demanded on it unless it has been shown to the maker. In the case of bill of exchange, the expression “after sight” means after acceptance, or after noting for non-acceptance or after protest for non-acceptance.

Ambiguous Instruments (Section 17)

An instrument, which in form is such that it may either be treated by the holder as a bill or as a note, is an ambiguous instrument. Section 5(2) of the English Bills of Exchange Act provides that where in a bill, the drawer and the drawee are the same person or where the drawee is a fictitious person or a person incompetent to contract, the holder may treat the instrument, at his option, either as a bill of exchange or as a promissory note.

Bill drawn to or to the order of the drawee or by an agent on his principal, or by one branch of a bank on another or by the direction of a company or their cashier are also ambiguous instruments. A promissory note addressed to a third person may be treated as a bill by such person by accepting it, while a bill not addressed to any one may be treated as a note. But where the drawer and payee are the same,e.g., where A draws a bill payable to A’s order, it is not an ambiguous instrument and cannot be treated as a promissory note. Once an instrument has been treated either as a bill or as a note, it cannot be treated differently afterwards.

Inchoate or Incomplete Instrument (Section 20)

When one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments, and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives *prima facie* authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein, and not exceeding the amount, covered

by the stamp. Such an instrument is called an inchoate instrument. The person so signing shall be liable upon such instrument, in the capacity in which he signs the same, to any holder in due course for such amount, provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended by him to be paid thereon.

The authority to fill up a blank or incomplete instrument may be exercised by any "holder" and not only the first holder to whom the instrument was delivered. The person signing and delivering the paper is liable both to a "holder" and a "holder-in-due- course". But there is a difference in their respective rights. A "holder" can recover only what the person signing and delivering the paper agreed to pay under the instrument, while a "holder-in- due-course" can recover the whole amount made payable by the instrument provided that it is covered by the stamp, even though the amount authorised was smaller.

Kinds of Negotiable Instruments

The Act recognises only three kinds of negotiable instruments under Section 13 but it does not exclude any other negotiable instrument provided the instrument entitles a person to a sum of money and is transferable by delivery. Instruments written in oriental languages i.e. hundis are also negotiable instruments. These instruments are discussed below:

(i) Promissory Notes

A "promissory note" is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money to, or to the order of, a certain person, or only to bearer of the instrument. (Section 4)

Parties to a Promissory Note:

A promissory note has the following parties:

(a) *The maker:* the person who makes or executes the note promising to pay the amount stated therein.

(b) *The payee:* one to whom the note is payable.

(c) *The holder:* is either the payee or some other person to whom he may have endorsed the note.

(d) *The endorser.*

(e) *The endorsee.*

Essentials of a Promissory Note:

To be a promissory note, an instrument must possess the following essentials:

(a) It must be in writing. An oral promise to pay will not do.

(b) It must contain an express promise or clear undertaking to pay. A promise to pay cannot be inferred. A mere acknowledgement of debt is not sufficient. If

A writes to B “I owe you (I.O.U.) Rs. 500", there is no promise to pay and the instrument is not a promissory note.

(c) The promise or undertaking to pay must be unconditional. A promise to pay “when able”, or “as soon as possible”, or “after your marriage to D”, is conditional. But a promise to pay after a specific time or on the happening of an event which must happen, is not conditional, e.g. “I promise to pay Rs. 1,000 ten days after the death of B”, is unconditional.

(d) The maker must sign the promissory note in token of an undertaking to pay to the payee or his order.

(e) The maker must be a certain person, i.e., the note must show clearly who is the person engaging himself to pay.

(f) The payee must be certain. The promissory note must contain a promise to pay to some person or persons ascertained by name or designation or to their order.

(g) The sum payable must be certain and the amount must not be capable of contingent additions or subtractions. If A promises to pay Rs. 100 and all other sums which shall become due to him, the instrument is not a promissory note.

(h) Payment must be in legal money of the country. Thus, a promise to pay Rs. 500 and deliver 10 quintals of rice is not a promissory note.

(i) It must be properly stamped in accordance with the provisions of the Indian Stamp Act. Each stamp must be duly cancelled by maker’s signature or initials.

(j) It must contain the name of place, number and the date on which it is made. However, their omission will not render the instrument invalid, e.g. if it is undated, it is deemed to be dated on the date of delivery.

Note : A promissory note cannot be made payable or issued to bearer, no matter whether it is payable on demand or after a certain time (Section 31 of the RBI Act).

(ii) Bills of Exchange

A “bill of exchange” is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of, a certain person or to the bearer of the instrument. (Section 5)

The definition of a bill of exchange is very similar to that of a promissory note and for most of the cases the rules which apply to promissory notes are in general applicable to bills. There are however, certain important points of distinction between the two.

Parties to bills of exchange

The following are parties to a bill of exchange:

(a) *The Drawer:* the person who draws the bill.

(b) *The Drawee:* the person on whom the bill is drawn.

(c) *The Acceptor:* one who accepts the bill. Generally, the drawee is the acceptor but a stranger may accept it on behalf of the drawee.

(d) *The payee:* one to whom the sum stated in the bill is payable, either the drawer or any other person may be the payee.

(e) *The holder:* is either the original payee or any other person to whom, the payee has endorsed the bill. In case of a bearer bill, the bearer is the holder.

(f) *The endorser:* when the holder endorses the bill to any one else he becomes the endorser.

(g) *The endorsee:* is the person to whom the bill is endorsed.

(h) *Drawee in case of need:* Besides the above parties, another person called the "drawee in case of need", may be introduced at the option of the drawer. The name of such a person may be inserted either by the drawer or by any endorser in order that resort may be had to him in case of need, i.e., when the bill is dishonoured by either non-acceptance or non-payment.

(i) *Acceptor for honour:* Further, any person may voluntarily become a party to a bill as acceptor. A person, who on the refusal by the original drawee to accept the bill or to furnish better security, when demanded by the notary, accept the bill supra protest in order to safeguard the honour of the drawer or any endorser, is called the acceptor for honour.

Essentials of a Bill of Exchange:

(1) It must be in writing.

(2) It must contain an unconditional order to pay money only and not merely a request.

(3) It must be signed by the drawer.

(4) The parties must be certain.

(5) The sum payable must also be certain.

(6) It must comply with other formalities e.g. stamps, date, etc.

Distinction between Bill of Exchange and Promissory Note

The following are the important points of distinction between a bill of exchange and a promissory note:

(a) A promissory note is a two-party instrument, with a maker (debtor) and a payee (creditor). In a bill there are three parties—drawer, drawee and payee, though any two out of the three capacities may be filled by one and the same person. In a bill, the drawer is the maker who orders the drawee to pay the bill to a person called the payee or to his order. When the drawee accepts the bill he is called the acceptor.

(b) A note cannot be made payable to the maker himself, while in a bill, the drawer and payee may be the same person.

(c) A note contains an unconditional promise by the maker to pay to the payee or his order; in a bill there is an unconditional order to the drawee to pay according to the directions of the drawer.

(d) A note is presented for payment without any prior acceptance by the maker.

A bill payable after sight must be accepted by the drawee or someone else on his behalf before it can be presented for payment.

(e) The liability of the maker of a pro-note is primary and absolute, but the liability of the drawer of a bill is secondary and conditional.

(f) Foreign bill must be protested for dishonour but no such protest is necessary in the case of a note.

(g) When a bill is dishonoured, due notice of dishonour is to be given by the holder to the drawer and the intermediate endorsee, but no such notice need to be given in the case of a note.

(h) A bill can be drawn payable to bearer provided it is not payable on demand. A promissory note cannot be made payable to bearer, even if it is made payable otherwise than on demand.

How Bill of Exchange Originates—Forms of Bills of Exchange

Bills of exchange were originally used for payment of debts by traders residing in one country to another country with a view to avoid transmission of coin. Now-a-days they are used more as trade bills both in connection with domestic trade and foreign trade and are called inland bills and foreign bills respectively.

Inland Bills (Sections 11 and 12)

A bill of exchange is an inland instrument if it is (i) drawn or made and payable in India, or (ii) drawn in India upon any person who is a resident in India, even though it is made payable in a foreign country. But a promissory note to be an inland should be drawn and payable in India, as it has no drawee.

Two essential conditions to make an inland instrument are:

(1) the instrument must have been drawn or made in India; and

(2) the instrument must be payable in India or the drawee must be in India.

*Examples:*A bill drawn in India, payable in USA, upon a person in India is an inland instrument. A bill drawn in India and payable in India but drawn on a person in USA is also an inland instrument.

Foreign Bills

All bills which are not inland are deemed to be foreign bills. Normally foreign bills are drawn in sets of three copies.

Trade Bill

A bill drawn and accepted for a genuine trade transaction is termed as a trade bill. When a trader sells goods on credit, he may make use of a bill of exchange. Suppose A sells goods worth Rs. 1,000 to B and allows him 90 days time to pay the price, A will draw a bill of exchange on B, in the following terms: “Ninety days after date pay A or order, the sum of one thousand rupees only for value received”. A will sign the bill and then present it to B for acceptance. This is necessary because, until a bill is accepted by the drawee, nobody has either rights or obligations. If B agrees to obey the order of A, he will accept the bill by writing across its face the word “accepted” and signing his name underneath and then delivering the bill to the holder. B, the drawee, now becomes the acceptor of the bill and liable to its holders. Such a bill is a genuine

trade bill.

Accommodation Bill

All bills are not genuine trade bills, as they are often drawn for accommodating a party. An accommodation bill is a bill in which a person lends or gives his name to oblige a friend or some person whom he knows or otherwise. In other words, a bill which is drawn, accepted or endorsed without consideration is called an accommodation bill. The party lending his name to oblige the other party is known as the accommodating or accommodation party, and the party so obliged is called the party accommodated. An accommodation party is not liable on the instrument to the party accommodated because as between them there was no consideration and the instrument was merely to help. But the accommodation party is liable to a holder for value, who takes the accommodation bill for value, though such holder may not be a holder in due course. Thus, A may be in need of money and approach his friends B and C who, instead of lending the money directly, propose to draw an "Accommodation Bill" in his favour in the following form:

"Three months after date pay A or order, the sum of Rupees one thousand only".

B.

To

C.

If the credit of B<N>and C is good, this device enables<N>A to get an advance of Rs. 1,000 from his banker at the commercial rate of discount. The real debtor in this case is not C, but A the payee who promises to reimburse C before the period of three months only. A is here the principal debtor and B and C are mere sureties. This inversion of liability affords a good definition of an accommodation bill: "If as between the original parties to the bill the one who should prima facie be principal is in fact the surety whether he be drawer, acceptor, or endorser, that bill is an accommodation bill".

Bills in Sets (Section 132 and 133)

Foreign bills are usually drawn in sets to avoid the danger of loss. They are drawn in sets of three, each of which is called "Via" and as soon as any one of them is paid, the others become inoperative. All these parts form one bill and the drawer must sign and deliver all of them to the payee. The stamp is affixed only on one part and one part is required to be accepted. But if the drawer mistakenly accepts all the parts of the same bill, he will be liable on each part accepted as if it were a separate bill.

Right to Duplicate Bill

Where a bill of exchange has been lost before it was overdue, the person who was the holder to it may apply to the drawer, to give him another bill of the same tenor. It is only the holder who can ask for a duplicate bill, promissory note or cheque.

Bank Draft

A bill of exchange is also sometimes spoken of as a draft. It is called as a bank draft when a bill of exchange drawn by one bank on another bank, or by itself on its own branch, and is a negotiable instrument. It is very much like the cheque with three

points of distinction between the two. A bank draft can be drawn only by a bank on another bank, usually its own branch. It cannot so easily be counter-manded. It cannot be made payable to bearer.

Specimen of a Bank Draft

A.B.C. Bank
X.Y.Z. Branch

No..... Date.....

On demand pay 'A' or order the sum of rupees one thousand five hundred only for value received.

Rs. 1500/-

Sd./-
Manager

To
'B' Branch, (Place)

In the above demand draft the drawer is X.Y.Z. Branch, the drawee is 'B' branch and the payee is 'A'.

(iii) Cheques

The Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 has broadened, the definition of cheque to include the electronic image of a truncated cheque and a cheque in the electronic form. Section 6***** of the Act provides that a 'cheque' is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.******

Despite the amendment as is evident the basic definition of the cheque has been retained and the definition has only been enlarged to include cheques in the above form as well.

As per explanation appended to the section, the expression:

(a) 'a cheque in the electronic form' means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system;

***** Substituted by Amendment Act, 2002.

****** Before the amendment, the definition read as 'a cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand'.

(b) 'a truncated cheque' means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing. (Explanation I).

The expression 'clearing house' means the clearing house managed by the Reserve Bank of India or a clearing house recognised as such by the Reserve Bank of India. (Explanation II).

Simply stated, a cheque is a bill of exchange drawn on a bank payable always on demand. Thus, a cheque is a bill of exchange with two additional qualifications, namely: (i) it is always drawn on a banker, and (ii) it is always payable on demand. A cheque being a species of a bill of exchange, must satisfy all the requirements of a bill; it does not, however, require acceptance.

Note: By virtue of Section 31 of the Reserve Bank of India Act, no bill of exchange or hundi can be made payable to bearer on demand and no promissory note or a bank draft can be made payable to bearer at all, whether on demand or after a specified time. Only a cheque can be payable to bearer on demand.

Parties to a cheque

The following are the parties to a cheque:

(a) The drawer: The person who draws the cheque.
(b) The drawee: The banker of the drawer on whom the cheque is drawn.
(c), (d), (e) and (f) The payee, holder, endorser and endorsee: same as in the case of a bill.

Essentials of a Cheque

(1) It is always drawn on a banker.
(2) It is always payable on demand.
(3) It does not require acceptance. There is, however, a custom among banks to mark cheques as good for purposes of clearance.
(4) A cheque can be drawn on bank where the drawer has an account.
(5) Cheques may be payable to the drawer himself. It may be made payable to bearer on demand unlike a bill or a note.
(6) The banker is liable only to the drawer. A holder has no remedy against the banker if a cheque is dishonoured.
(7) A cheque is usually valid for fix months. However, it is not invalid if it is post dated or ante-dated.
(8) No Stamp is required to be affixed on cheques.

Distinction between Cheques and Bills of Exchange

As a general rule, the provisions applicable to bills payable on demand apply to cheques, yet there are few points of distinction between the two, namely:

(a) A cheque is a bill of exchange and always drawn on a banker, while a bill may be drawn on any one, including banker.
(b) A cheque can only be drawn payable on demand, a bill may be drawn payable on demand, or on the expiry of a specified period after sight or date.
(c) A bill payable after sight must be accepted before payment can be demanded, a cheque does not require acceptance and is intended for

immediate payment.

(d) A grace of 3 days is allowed in the case of time bills, while no grace is given in the case of a cheque, for payment.

(e) The drawer of a bill is discharged, if it is not presented for payment, but the drawer of a cheque is discharged only if he suffers any damage by delay in presentment for payment.

(f) Notice of the dishonour of a bill is necessary, but not in the case of a cheque.

(g) The cheque being a revocable mandate, the authority may be revoked by countermanding payment, and is determined by notice of the customer's death or insolvency. This is not so in the case of bill.

(h) A cheque may be crossed, but not a bill.

A cheque is a bill of exchange drawn on a specified banker and always payable on demand. A cheque is always drawn on a particular banker and is always payable on demand. Consequently, all cheques are bills of exchange but all bills are not cheques.

Specimen of a Cheque

A.B.C. Bank
X.Y.Z. Branch

Date.....

Pay 'A'..... or the bearer sum of rupees..... only.

Rs...../-

A/c No.....LF.....

No..... Sd/-

Banker

A banker is one who does banking business. Section 5(b) of the Banking Regulation Act, 1949 defines banking as, "accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft or otherwise." This definition emphasises two points: (1) that the primary function of a banker consists of accepting of deposits for the purpose of lending or investing the same; (2) that the amount deposited is repayable to the depositor on demand or according to the agreement. The demand for repayment can be made through a cheque, draft or otherwise, and not merely by verbal order.

Customer

The term "customer" is neither defined in Indian nor in English statutes. The general opinion is that a customer is one who has an account with the bank or who utilises the services of the bank.

The special features of the legal relationship between the banker and the customer may be termed as the obligations and rights of the banker. These are:

1. Obligation to honour cheques of the customers.
2. Obligation to collect cheques and drafts on behalf of the customers.
3. Obligation to keep proper record of transactions with the customer.
4. Obligation to comply with the express standing instructions of the customer.
5. Obligation not to disclose the state of customer's account to anyone else.
6. Obligation to give reasonable notice to the customer, if the banker wishes to close the account.
7. Right of lien over any goods and securities bailed to him for a general balance of account.
8. Right of set off and right of appropriation.
9. Right to claim incidental charges and interest as per rules and regulations of the bank, as communicated to the customer at the time of opening the account.

Liability of a Banker

By opening a current account of a customer, the banker becomes liable to his debtor to the extent of the amount so received in the said account and undertakes to honour the cheques drawn by the customer so long as he holds sufficient funds to the customer's credit. If a banker, without justification, fails to honour his customer's cheques, he is liable to compensate the drawer for any loss or damage suffered by him. But the payee or holder of the cheque has no cause of action against the banker as the obligation to honour a cheque is only towards the drawer.

The banker must also maintain proper and accurate accounts of credits and debits. He must honour a cheque presented in due course. But in the following circumstances, he must refuse to honour a cheque and in some others he may do so.

8. When Banker must Refuse Payment

In the following cases the authority of the banker to honour customer's cheque comes to an end, he must refuse to honour cheques issued by the customer:

(a) When a customer countermands payment i.e., where or when a customer, after issuing a cheque issues instructions not to honour it, the banker must not pay it.
(b) When the banker receives notice of customer's death.
(c) When customer has been adjudged an insolvent.
(d) When the banker receives notice of customer's insanity.
(e) When an order (e.g., Garnishee Order) of the Court, prohibits payment.
(f) When the customer has given notice of assignment of the credit balance of his account.
(g) When the holder's title is defective and the banker comes to know of it.
(h) When the customer has given notice for closing his account.

When Banker may Refuse Payment

In the following cases the banker may refuse to pay a customer's cheque:

(a) When the cheque is post-dated.
(b) When the banker has no sufficient funds of the drawer with him and there is

no communication between the bank and the customer to honour the cheque.

(c) When the cheque is of doubtful legality.
(d) When the cheque is not duly presented, e.g., it is presented after banking hours.
(e) When the cheque on the face of it is irregular, ambiguous or otherwise materially altered.
(f) When the cheque is presented at a branch where the customer has no account.
(g) When some persons have joint account and the cheque is not signed jointly by all or by the survivors of them.
(h) When the cheque has been allowed to become stale, i.e., it has not been presented within six months of the date mentioned on it.

Protection of Paying Banker (Sections 10, 85 and 128)

Section 85 lays down that where a cheque payable to order purports to be endorsed by or on behalf of the payee the banker is discharged by payment in due course. He can debit the account of the customer with the amount even though the endorsement turns out subsequently to have been forged, or the agent of the payee without authority endorsed it on behalf of the payee. It would be seen that the payee includes endorsee. This protection is granted because a banker cannot be expected to know the signatures of all the persons in the world. He is only bound to know the signatures of his own customers.

Therefore, the forgery of drawer's signature will not ordinarily protect the banker but even in this case, the banker may debit the account of the customer, if it can show that the forgery was intimately connected with the negligence of the customer and was the proximate cause of loss.

In the case of bearer cheques, the rule is that once a bearer cheque, always a bearer cheque. Where, therefore, a cheque originally expressed by the drawer himself to be payable to bearer, the banker may ignore any endorsement on the cheque. He will be discharged by payment in due course. But a cheque which becomes bearer by a subsequent endorsement in blank is not covered by this Section. A banker is discharged from liability on a crossed cheque if he makes payment in due course.

Payment in due Course (Section 10)

Any person liable to make payment under a negotiable instrument, must make the payment of the amount due thereunder in due course in order to obtain a valid discharge against the holder.

A payment in due course means a payment in accordance with the apparent tenor of the instrument, in good faith and without negligence to any person in possession thereof.

A payment will be a payment in due course if:

(a) it is in accordance with the apparent tenor of the instrument, i.e., according to what appears on the face of the instrument to be the intention of the parties;
(b) it is made in good faith and without negligence, and under circumstances

which do not afford a ground for believing that the person to whom it is made is not entitled to receive the amount;

(c) it is made to the person in possession of the instrument who is entitled as holder to receive payment;

(d) payment is made under circumstances which do not afford a reasonable ground believing that he is not entitled to receive payment of the amount mentioned in the instrument; and

(e) payment is made in money and money only.

Under Sections 10 and 128, a paying banker making payment in due course is protected.

Collecting Banker

Collecting Banker is one who collects the proceeds of a cheque for a customer. Although a banker collects the proceeds of a cheque for a customer purely as a matter of service, yet the Negotiable Instruments Act, 1881 indirectly imposes statutory obligation, statutory in nature. This is evident from Section 126 of the Act which provides that a cheque bearing a "general crossing" shall not be paid to anyone other than banker and a cheque which is "specially crossed" shall not be paid to a person other than the banker to whom it is crossed. Thus, a paying banker must pay a generally crossed cheque only to a banker thereby meaning that it should be collected by another banker. While so collecting the cheques for a customer, it is quite possible that the banker collects for a customer, proceeds of a cheque to which the customer had no title in fact. In such cases, the true owner may sue the collecting banker for "conversion". At the same time, it cannot be expected of a banker to know or to ensure that all the signatures appearing in endorsements on the reverse of the cheque are genuine. The banker is expected to be conversant only with the signatures of his customer. A customer to whom a cheque has been endorsed, would request his banker to collect a cheque. In the event of the endorser's signature being proved to be forged at later date, the banker who collected the proceeds should not be held liable for the simple reason that he has merely collected the proceeds of a cheque. Section 131 of the Negotiable Instruments Act affords statutory protection in such a case where the customer's title to the cheque which the banker has collected has been questioned. It reads as follows:

"A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason of only having received such payment.

Explanation: A banker receives payment of a crossed cheque for a customer within the meaning of this section notwithstanding that he credits his customer's account with the amount of the cheque before receiving payment thereof."

The Amendment Act, 2002 has added a new explanation to Section 131 which provides that it shall be the duty of the banker who receives payment based on an electronic image of a truncated cheque held with him, to verify the *prima facie* genuineness of the cheque to be truncated and any fraud, forgery or tampering apparent on the face of the instrument that can be verified with due diligence and ordinary care. *(Explanation II)*

The requisites of claiming protection under Section 131 are as follows:

(i) The collecting banker should have acted in good faith and without negligence. An act is done in good faith when it is done honestly. The plea of good faith can be rebutted on the ground of recklessness indicative of want of proper care and attention. Therefore, much depends upon the facts of the case. The burden of proving that the cheque was collected in good faith and without negligence is upon the banker claiming protection. Failure to verify the regularity of endorsements, collecting a cheque payable to the account of the company to the credit of the director, etc. are examples of negligence.

(ii) The banker should have collected a crossed cheque, i.e., the cheque should have been crossed before it came to him for collection.

(iii) The proceeds should have been collected for a customer, i.e., a person who has an account with him.

(iv) That the collecting banker has only acted as an agent of the customer. If he had become the holder for value, the protection available under Section 131 is forfeited—Where for instance, the banker allows the customer to withdraw the amount of the cheque before the cheque is collected or where the cheque has been accepted in specific reduction of an overdraft, the banker is *deemed to have become the holder for value and the protection is lost*. But the explanation to Section 131 says that the mere crediting of the amount to the account does not imply that the banker has become a holder for value because due to accounting conveniences the banker may credit the account of the cheque to the customer's account even before proceeds thereof are realised.

Overdue, Stale or Out-of-date Cheques

A cheque is overdue or becomes statute-barred after three years from its due date of issue. A holder cannot sue on the cheque after that time. Apart from this provision, the holder of a cheque is required to present it for payment within a reasonable time, as a cheque is not meant for indefinite circulation. In India, a cheque, which has been in circulation for more than six months, is regarded by bankers as stale. If, as a result of any delay in presenting a cheque, the drawer suffers any loss, as by the failure of the bank, the drawer is discharged from liability to the holder to the extent of the damage.

Liability of Endorser

In order to charge an endorser, it is necessary to present the cheque for payment within a reasonable time of its delivery by such endorser. 'A' endorses and delivers a cheque to B, and B keeps it for an unreasonable length of time, and then endorses and delivers it to C. C presents it for payment within a reasonable time after its receipt by him, and it is dishonoured. C can enforce payment against B but not against A, as *qua* A, the cheque has become stale.

Rights of Holder against Banker

A banker is liable to his customer for wrongful dishonour of his cheque but it is not liable to the payee or holder of the cheque. The holder has no right to enforce payment from the banker except in two cases, namely, (i) where the holder does not

present the cheque within a reasonable time after issue, and as a result the drawer suffers damage by the failure of the banker in liquidation proceedings; and (ii) where a banker pays a crossed cheque by mistake over the counter, he is liable to the owner for any loss occasioned by it.

Crossing of Cheques

A cheque is either "open" or "crossed". An open cheque can be presented by the payee to the paying banker and is paid over the counter. A crossed cheque cannot be paid across the counter but must be collected through a banker.

A crossing is a direction to the paying banker to pay the money generally to a banker or to a particular banker, and not to pay otherwise. The object of crossing is to secure payment to a banker so that it could be traced to the person receiving the amount of the cheque. Crossing is a direction to the paying banker that the cheque should be paid only to a banker or a specified banker. To restrain negotiability, addition of words "Not Negotiable" or "Account Payee Only" is necessary. A crossed bearer cheque can be negotiated by delivery and crossed order cheque by endorsement and delivery. Crossing affords security and protection to the holder of the cheque.

Modes of Crossing (Sections 123-131A)

There are two types of crossing which may be used on cheque, namely: (i) General, and (ii) Special. To these may be added another type, i.e. Restrictive crossing.

It is general crossing where a cheque bears across its face an addition of two parallel transverse lines and/or the addition of the words "and Co." between them, or addition of "not negotiable". As stated earlier, where a cheque is crossed generally, the paying banker will pay to any banker. Two transverse parallel lines are essential for a general crossing (Sections 123-126).

In case of general crossing, the holder or payee cannot get the payment over the counter of the bank but through a bank only. The addition of the words "and Co." do not have any significance but the addition of the words "not negotiable" restrict the negotiability of the cheque and in case of transfer, the transferee will not give a better title than that of a transferor.

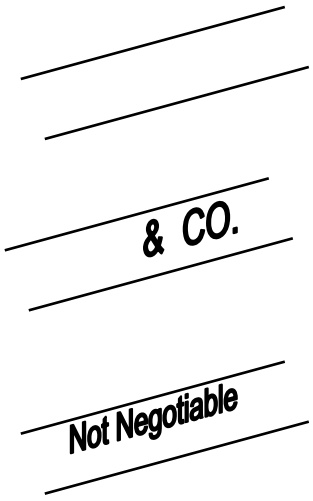
Where a cheque bears across its face an addition of the name of a banker, either with or without the words "not negotiable" that addition constitutes a crossing and the cheque is crossed specially and to that banker. The paying banker will pay only to the banker whose name appears across the cheque, or to his collecting agent. Parallel transverse lines are not essential but the name of the banker is the insignia of a special crossing.

In case of special crossing, the paying banker is to honour the cheque only when it is prescribed through the bank mentioned in the crossing or it's agent bank.

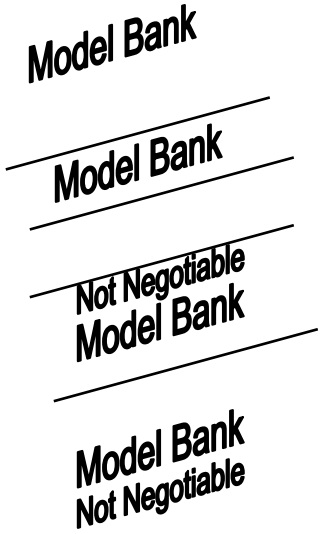
Account Payee's Crossing: Such crossing does, in practice, restrict negotiability of a cheque. It warns the collecting banker that the proceeds are to be credited only to the account of the payee, or the party named, or his agent. If the collecting banker

allows the proceeds of a cheque bearing such crossing to be credited to any other account, he will be guilty of negligence and will not be entitled to the protection given to collecting banker under Section 131. Such crossing does not affect the paying banker, who is under no duty to ascertain that the cheque is in fact collected for the account of the person named as payee.

Specimen of a general crossing



Specimen of a special crossing



Not Negotiable Crossing

A cheque may be crossed not negotiable by writing across the face of the cheque the words “Not Negotiable” within two transverse parallel lines in the case of a general crossing or alongwith the name of a banker in the case of a special crossing. Section 130 of the Negotiable Instruments Act provides “A person taking a cheque crossed generally or specially bearing in either case with the words ”not negotiable" shall not have and shall not be capable of giving, a better title to the cheque than that which the person from whom he took it had". The crossing of cheque “not negotiable” does not mean that it is non-transferable. It only deprives the instrument of the incident of negotiability. Normally speaking, the essential feature of a negotiable instrument as opposed to chattels is that a person who takes the instrument in good faith, without negligence, for value, before maturity and without knowledge of the defect in the title of the transferor, gets a good title to the instrument. In other words, he is called a holder in due course who acquires an indisputable title to the cheque. (When the instrument passes through a holder-in-due course, it is purged of all defects and the subsequent holders also get good title). It is exactly this important feature which is taken away by crossing the cheque “not negotiable”. In other words, a cheque crossed “not negotiable” is like any other chattel and therefore the transferee gets same title to the cheque which his transferor had. That is to say that

the transferee cannot claim the rights of a holder-in-due-course. So long as the title of the transferors is good, the title of the transferees is also good but if there is a taint in the title to the cheque of one of the endorsers, then all the subsequent transferees' title also become tainted with the same defectthey cannot claim to be holders-in-due-course.

The object of this Section is to afford protection to the drawer or holder of a cheque who is desirous of transmitting it to another person, as much protection as can reasonably be afforded to him against dishonestly or actual miscarriage in the course of transit. For example, a cheque payable to bearer is crossed generally and is marked "not negotiable". It is lost or stolen and comes into the possession of X who takes it in good faith and gives value for it, X collects the cheque through his bank and paying banker also pays. In this case, both the paying and the collecting bankers are protected under Sections 128 and 131 respectively. But X cannot claim that he is a holder-in-due course which he could have under the normal circumstances claimed. The reason is that cheque is crossed "not negotiable" and hence the true owner's (holder's) right supercedes the rights of the holder-in-due-course. Since X obtained the cheque from a person who had no title to the cheque (i.e. from one whose title was defective) X can claim no better title solely because the cheque was crossed "not negotiable" and not for any other reason. Thus "not negotiable" crossing not only protects the rights of the true owner of the cheque but also serves as a warning to the endorsees' to enquire thoroughly before taking the cheque as they may have to be answerable to the true owner thereof if the endorser's title is found to be defective.

"Not negotiable" restricts the negotiability of the cheque and in case of transfer, the transferee will not get a better title than that of a transferor.

If the cheque becomes "not negotiable" it lacks negotiability. A cheque crossed specially or generally bearing the words "not negotiable", lacks negotiability and therefore is not a negotiable instrument in the true sense. It does not restrict transferability but restricts negotiability only.

Maturity

Cheques are always payable on demand but other instruments like bills, notes, etc. may be made payable on a specified date or after the specified period of time. The date on which payment of an instrument falls due is called its maturity. According to Section 22 of the Act, "the maturity of a promissory note or a bill of exchange is the date at which it falls due". According to Section 21 a promissory note or bill of exchange payable "at sight" or "on presentment" is payable on demand. It is due for payment as soon as it is issued. The question of maturity, therefore, arises only in the case of a promissory note or a bill of exchange payable "after date" or "after sight" or at a certain period after the happening of an event which is certain to happen.

Maturity is the date on which the payment of an instrument falls due. Every instrument payable at a specified period after date or after sight is entitled to three days of grace. Such a bill or note matures or falls due on the last day of the grace period, and must be presented for payment on that day and if dishonoured, suit can be instituted on the next day after maturity. If an instrument is payable by instalments, each instalment is entitled to three days of grace. No days of grace are allowed for cheques, as they are payable on demand.

Where a note or bill is expressed to be payable on the expiry of specified number

of months after sight, or after date, the period of payment terminates on the day of the month which corresponds with the date of instrument, or with the date of acceptance if the bill be accepted or presented for sight, or noted or protested for non-acceptance. If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.

Illustrations

(i) A negotiable instrument dated 31st January, 2001, is made payable at one months after date. The instrument is at maturity on the third day after the 28th February, 2001, i.e. on 3rd March, 2001.

(ii) A negotiable instrument dated 30th August, 2001, is made payable three months after date. The instrument is at maturity on 3rd December, 2001.

(iii) A negotiable instrument dated the 31st August, 2001, is made payable three months after date. The instrument is at maturity on 3rd December, 2001.

If the day of maturity falls on a public holiday, the instrument is payable on the preceeding business day. Thus, if a bill is at maturity on a Sunday. It will be deemed due on Saturday and not on Monday.

The ascertainment of the date of maturity becomes important because all these instruments must be presented for payment on the last day of grace and their payment cannot be demanded before that date. Where an instrument is payable by instalments, it must be presented for payment on the third day after the day fixed for the payment of each instalment.

Holder

According to Section 8 of the Act a person is a holder of a negotiable instrument who is entitled in his own name (i) to the possession of the instrument, and (ii) to recover or receive its amount from the parties thereto. It is not every person in possession of the instrument who is called a holder. To be a holder, the person must be named in the instrument as the payee, or the endorsee, or he must be the bearer thereof. A person who has obtained possession of an instrument by theft, or under a forged endorsement, is not a holder, as he is not entitled to recover the instrument. The holder implies de jure (holder in law) holder and not de facto (holder in fact) holder. An agent holding an instrument for his principal is not a holder although he may receive its payment.

Holder in Due Course

Section 9 states that a holder in due course is (i) a person who for consideration, obtains possession of a negotiable instrument if payable to bearer, or (ii) the payee or endorsee thereof, if payable to order, before its maturity and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

In order to be a holder in due course, a person must satisfy the following conditions:

(i) He must be the holder of the instrument.

(ii) He should have obtained the instrument for value or consideration.

(iii) He must have obtained the negotiable instrument before maturity.

(iv) The instrument should be complete and regular on the face of it.

(v) The holder should take the instrument in good faith.

A holder in due course is in a privileged position. He is not only himself protected against all defects of the persons from whom he received the instrument as current coin, but also serves as a channel to protect all subsequent holders. A holder in due course can recover the amount of the instrument from all previous parties, although, as a matter of fact, no consideration was paid by some of the previous parties to the instrument or there was a defect of title in the party from whom he took it. Once an instrument passes through the hands of a holder in due course, it is purged of all defects. It is like current coin. Whoever takes it can recover the amount from all parties previous to such holder.

Capacity of Parties

Capacity to incur liability as a party to a negotiable instrument is co-extensive with capacity to contract. According to Section 26, every person capable of contracting according to law to which he is subject, may bind himself and be bound by making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

Negatively, minors, lunatics, idiots, drunken person and persons otherwise disqualified by their personal law, do not incur any liability as parties to negotiable instruments. But incapacity of one or more of the parties to a negotiable instrument in no way, diminishes the abilities and the liabilities of the competent parties. Where a minor is the endorser or payee of an instrument which has been endorsed all the parties accepting the minor are liable in the event of its dishonour.

Liability of Parties

The provisions regarding the liability of parties to negotiable instruments are laid down in Sections 30 to 32 and 35 to 42 of the Negotiable Instruments Act. These provisions are as follows:

1. Liability of Drawer (Section 30)

The drawer of a bill of exchange or cheque is bound, in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been given to or received by the drawer.

The nature of drawer's liability is that by drawing a bill, he undertakes that (i) on due presentation, it shall be accepted and paid according to its tenor, and (ii) in case of dishonour, he will compensate the holder or any endorser, provided notice of dishonour has been duly given. However, in case of accommodation bill no notice of dishonour to the drawer is required.

The liability of a drawer of a bill of exchange is secondary and arises only on default of the drawee, who is primarily liable to make payment of the negotiable instrument.

2. Liability of the Drawee of Cheque (Section 31)

The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required to do so and, or in default of such payment, he shall compensate the drawer for any loss or damage caused by such default.

As a cheque is a bill of exchange, drawn on a specified banker, the drawee of a cheque must always be a banker. The banker, therefore, is bound to pay the cheque of the drawer, i.e., customer, if the following conditions are satisfied:

(i) The banker has sufficient funds to the credit of customer's account.

(ii) The funds are properly applicable to the payment of such cheque, e.g., the funds are not under any kind of lien etc.

(iii) The cheque is duly required to be paid, during banking hours and on or after the date on which it is made payable.

If the banker is unjustified in refusing to honour the cheque of its customer, it shall be liable for damages.

3. Liability of "Maker" of Note and "Acceptor" of Bill (Section 32)

In the absence of a contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity, according to the apparent tenor of the note or acceptance respectively. The acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand.

It follows that the liability of the acceptor of a bill corresponds to that of the maker of a note and is absolute and unconditional but the liability under this Section is subject to a contract to the contrary (e.g., as in the case of accommodation bills) and may be excluded or modified by a collateral agreement. Further, the payment must be made to the party named in the instrument and not to any-one else, and it must be made at maturity and not before.

4. Liability of endorser (Section 35)

Every endorser incurs liability to the parties that are subsequent to him. Whoever endorses and delivers a negotiable instrument before maturity is bound thereby to every subsequent holder in case of dishonour of the instrument by the drawee, acceptor or maker, to compensate such holder of any loss or damage caused to him by such dishonour provided (i) there is no contract to the contrary; (ii) he (endorser) has not expressly excluded, limited or made conditional his own liability; and (iii) due notice of dishonour has been given to, or received by, such endorser. Every endorser after dishonour, is liable upon the instrument as if it is payable on demand.

He is bound by his endorsement notwithstanding any previous alteration of the instrument. (Section 88)

5. Liability of Prior Parties (Section 36)

Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied. Prior parties may include the maker or drawer, the acceptor and all the intervening endorsers to a negotiable instrument.

The liability of the prior parties to a holder in due course is joint and several. The holder in due course may hold any or all prior parties liable for the amount of the dishonoured instrument.

6. Liability inter se

Various parties to a negotiable instrument who are liable thereon stand on a different footing with respect to the nature of liability of each one of them.

7. Liability of Acceptor of Forged Endorsement (Section 41)

An acceptor of a bill of exchange already endorsed is not relieved from liability by reason that such endorsement is forged, if he knew or had reason to believe the endorsement to be forged when he accepted the bill.

8. Acceptor's Liability on a Bill drawn in a Fictitious Name

An acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due course claiming under an endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer.

Negotiation (Section 14)

A negotiable instrument may be transferred by negotiation or assignment. Negotiation is the transfer of an instrument (a note, bill or cheque) for one person to another in such a manner as to convey title and to constitute the transferee the holder thereof[*]. When a negotiable instrument is transferred by negotiation, the rights of the transferee may rise higher than those of the transferor, depending upon the circumstances attending the negotiation. When the transfer is made by assignment, the assignee has only those rights which the assignor possessed. In case of assignment, there is a transfer of ownership by means of a written and registered document.

Negotiability and Assignability Distinguished

A transfer by negotiation differs from transfer by assignment in the following respects:

(a) Negotiation requires mere delivery of a bearer instrument and endorsement and delivery of an order instrument to effectuate a transfer. Assignment requires a written document signed by the transferor.

(b) Notice of transfer of debt (actionable claim) must be given by the assignee to the debtor in order to complete his title; no such notice is necessary in a transfer by negotiation.

(c) On assignment, the transferee of an actionable claim takes it subject to all the defects in the title of, and subject to all the equities and defences available against the assignor, even though he took the assignment for value and in good faith. In case of negotiation the transferee, as holder-in-due course, takes the instrument free from any defects in the title of the transferor.

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[*] Section 14 reads "When a promissory note, bill of exchange or cheque is transferred to any person, so as to constitute that person the holder thereof, the instrument is said to be negotiable".

Importance of Delivery

Negotiation is effected by mere delivery of a bearer instrument and by endorsement and delivery of an order instrument. This shows that "delivery" is essential in negotiable instruments. Section 46 expressly provides that making acceptance or endorsement of negotiable instrument is not complete until delivery, actual or constructive, of the instrument. Delivery made voluntarily with the intention of passing property in the instrument to the person to whom it is given is essential.

Negotiation by Mere Delivery

A bill or cheque payable to bearer is negotiated by mere delivery of the instrument. An instrument is payable to bearer:

(i) Where it is made so payable, or

(ii) Where it is originally made payable to order but the only or the last endorsement is in blank.

(iii) Where the payee is a fictitious or a non-existing person.

These instruments do not require signature of the transferor. The person who takes them is a holder, and can sue in his own name on them. Where a bearer negotiates an instrument by mere delivery, and does not put his signature thereon, he is not liable to any party to the instrument in case the instrument is dishonoured, as he has not lent his credit to it. His obligations are only towards his immediate transferee and to no other holders.

A cheque, originally drawn payable to bearer remains bearer, even though it is subsequently endorsed in full. The rule is once a bearer cheque always a bearer cheque.

Negotiation by Endorsement and Delivery

An instrument payable to a specified person or to the order of a specified person or to a specified person or order is an instrument payable to order. Such an instrument can be negotiated only by endorsement and delivery. Unless the holder signs his endorsement on the instrument, the transferee does not become a holder. Where an instrument payable to order is delivered without endorsement, it is merely assigned and not negotiated and the holder thereof is not entitled to the rights of a holder in due course, and he cannot negotiate it to a third person.

Endorsement (Sections 15 and 16)

Where the maker or holder of a negotiable instrument signs the same otherwise than as such maker for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto (called Allonge), or so, signs for the same purpose, a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same (Section 15), the person to whom the instrument is endorsed is called the endorsee.

In other words, 'endorsement' means and involves the writing of something on the back of an instrument for the purpose of transferring the right, title and interest therein to some other person.

Classes of endorsement

An endorsement may be (a) Blank or General, (b) Special or Full, (c) Restrictive, or (d) Partial, and (e) Conditional or Qualified.

(a) *Blank or General:* An endorsement is to be blank or general where the endorser merely writes his signature on the back of the instrument, and the instrument so endorsed becomes payable to bearer, even though originally it was payable to order. Thus, where bill is payable to "Mohan or order", and he writes on its back "Mohan", it is an endorsement in blank by Mohan and the property in the bill can pass by mere delivery, as long as the endorsement continues to be a blank. But a holder of an instrument endorsed in blank may convert the endorsement in blank into an endorsement in full, by writing above the endorser's signature, a direction to pay the instrument to another person or his order.

(b) *Special or Full:* If the endorser signs his name and adds a direction to pay the amount mentioned in the instrument to, or to the order of a specified person, the endorsement is said to be special or in full. A bill made payable to Mohan or Mohan or order, and endorsed "pay to the order of Sohan" would be specially endorsed and Sohan endorses it further. A blank endorsement can be turned into a special one by the addition of an order making the bill payable to the transferee.

(c) *Restrictive:* An endorsement is restrictive which prohibits or restricts the further negotiation of an instrument. Examples of restrictive endorsement: "Pay A only" or "Pay A for my use" or "Pay A on account of B" or "Pay A or order for collection".

(d) *Partial:* An endorsement partial is one which purports to transfer to the endorsee a part only of the amount payable on the instrument. A partial endorsement does not operate as negotiation of the instrument. A holds a bill for Rs. 1,000 and endorses it as "Pay B or order Rs. 500". The endorsement is partial and invalid.

(e) *Conditional or qualified:* An endorsement is conditional or qualified which limits or negatives the liability of the endorser. An endorser may limit his liability in any of the following ways:

  (i) By sans recourse endorsement, i.e. by making it clear that he does not incur the liability of an endorser to the endorsee or subsequent holders and they should not look to him in case of dishonour of instrument. The endorser excludes his liability by adding the words "sans recourse" or "without recourse", e.g., "pay A or order sans recourse".

  (ii) By making his liability depending upon happening of a specified event which may never happen, e.g., the holder of a bill may endorse it thus: "Pay A or order on his marrying B". In such a case, the endorser will not be liable until A marries B.

It is pertinent to refer to Section 52 of the Negotiable Instruments Act, 1881 here. It reads "The endorser of a negotiable instrument may, by express words in the

endorsement exclude his own liability thereon, or make such liability or the right of the endorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen".

Negotiation Back

Where an endorser negotiates an instrument and again becomes its holder, the instrument is said to be negotiated back to that endorser and none of the intermediary endorsees are then liable to him. The rule prevents a circuity of action. For example, A, the holder of a bill endorses it to B, B endorses to C, and C to D, and endorses it again to A. A, being a holder in due course of the bill by second endorsement by D, can recover the amount thereof from B, C, or D and himself being a prior party is liable to all of them. Therefore, A having been relegated by the second endorsement to his original position, cannot sue B, C and D.

Where an endorser so excludes his liability and afterwards becomes the holder of the instrument, all the intermediate endorsers are liable to him. "the italicised portion of the above Section is important". An illustration will make the point clear. A is the payee of a negotiable instrument. He endorses the instrument 'sans recourse' to B, B endorses to C, C to D, and D again endorses it to A. In this case, A is not only reinstated in his former rights but has the right of an endorsee against B, C and D.

Negotiation of Lost Instrument or that Obtained by Unlawful Means

When a negotiable instrument has been lost or has been obtained from any maker, acceptor or holder thereof by means of an offence or fraud, or for an unlawful consideration, no possessor or endorsee, who claims through the person who found or obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor, or holder from any party prior to such holder unless such possessor or endorsee is, or some person through whom he claims was, a holder in due course.

Forged Endorsement

The case of a forged endorsement is worth special notice. If an instrument is endorsed in full, it cannot be negotiated except by an endorsement signed by the person to whom or to whose order the instrument is payable, for the endorsee obtains title only through his endorsement. Thus, if an instrument be negotiated by means of a forged endorsement, the endorsee acquires no title even though he be a purchaser for value and in good faith, for the endorsement is a nullity. Forgery conveys no title. *But where the instrument is a bearer instrument or has been endorsed in blank, it can be negotiated by mere delivery, and the holder derives his title independent of the forged endorsement and can claim the amount from any of the parties to the instrument.* For example, a bill is endorsed, "Pay A or order". A endorses it in blank, and it comes into the hands of B, who simply delivers it to C, C forges B's endorsement and transfer it to D. Here, D, as the holder does not derive his title through the forged endorsement of B, but through the genuine endorsement of A and can claim payment from any of the parties to the instrument in spite of the intervening forged endorsement.

Acceptance of a Bill of Exchange

The drawee of a bill of exchange, as such, has no liability on any bill addressed to him for acceptance or payment. A refusal to accept or to pay such bill gives the holder no rights against him. The drawee becomes liable only after he accepts the bill. The acceptor has to write the word 'accepted' on the bill and sign his name below it. Thus, it is the acceptor who is primarily liable on a bill.

The acceptance of a bill is the indication by the drawee of his assent to the order of the drawer. Thus, when the drawee writes across the face of the bill the word "accepted" and signs his name underneath he becomes the acceptor of the bill.

An acceptance may be either general or qualified. A general acceptance is absolute and as a rule, an acceptance has to be general. Where an acceptance is made subject to some condition or qualification, thereby varying the effect of the bill, it is a qualified acceptance. The holder of the bill may either refuse to take a qualified acceptance or non-acquiescence in it. Where he refuses to take it, he can treat the bill as dishonoured by non-acceptance, and sue the drawer accordingly.

Acceptance for Honour

When a bill has been noted or protested for non-acceptance or for better security, any person not being a party already liable thereon may, with the consent of the holder, by writing on the bill, accept the same for the honour of any party thereto. The stranger so accepting, will declare under his hand that he accepts the protested bill for the honour of the drawer or any particular endorser whom he names.

The acceptor for honour is liable to pay only when the bill has been duly presented at maturity to the drawee for payment and the drawee has refused to pay and the bill has been noted and protested for non-payment. Where a bill has been protested for non-payment after having been duly accepted, any person may intervene and pay it supra protest for the honour of any party liable on the bill. When a bill is paid *supra protest,* it ceases to be negotiable. The stranger, on paying for honour, acquires all the right of holder for whom he pays.

Presentment for Acceptance

It is only bills of exchange that require presentment for acceptance and even these of certain kinds only. Bills payable on demand or on a fixed date need not be presented. Thus, a bill payable 60 days after due date on the happening of a certain event may or may not be presented for acceptance. But the following bills must be presented for acceptance otherwise, the parties to the bill will not be liable on it:

(a) A bill payable *after sight*. Presentment is necessary in order to fix maturity of the bills; and

(b) A bill in which there is an express stipulation that it shall be presented for acceptance before it is presented for payment.

Section 15 provides that the presentment for acceptance must be made to the drawee or his duly authorised agent. If the drawee is dead, the bill should be presented to his legal representative, or if he has been declared an insolvent, to the official receiver or assigner.

The following are the persons to whom a bill of exchange should be presented:

(i) The drawee or his duly authorised agent.

(ii) If there are many drawees, bill must be presented to all of them.

(iii) The legal representatives of the drawee if drawee is dead.

(iv) The official receiver or assignee of insolvent drawee.

(v) To a drawee in case of need, if there is any. This is necessary when the original drawee refuses to accept the bill.

(vi) The acceptor for honour. In case the bill is not accepted and is noted or protested for non-acceptance, the bill may be accepted by the acceptor for honour. He is a person who comes forward to accept the bill when it is dishonoured by non-acceptance.

The presentment must be made before maturity, within a reasonable time after it is drawn, or within the stipulated period, if any, on a business day within business hours and at the place of business or residence of the drawee. The presentment must be made by exhibiting the bill to the drawee; mere notice of its existence in the possession of holder will not be sufficient.

When presentment is compulsory and the holder fails to present for acceptance, the drawer and all the endorsers are discharged from liability to him.

Presentment for Acceptance when Excused

Compulsory presentment for acceptance is excused and the bill may be treated as dishonoured in the following cases:

(a) Where the drawee cannot be found after reasonable search.

(b) Where drawee is a fictitious person or one incapable of contracting.

(c) Where although the presentment is irregular, acceptance has been refused on some other ground.

Presentment for Payment

Section 64 lays down the general rule as to presentment of negotiable instruments for payment. It says all notes, bills and cheques must be presented for payment thereof respectively by or on behalf of the holder during the usual hours of business and of the maker or acceptor, and if at banker's within banking hours. [Section 64(1)]

As mentioned earlier, the definition of cheque has been broadened to include the electronic image of a truncated cheque and a cheque in the electronic form. Thus, the section has also been suitably amended to provide rules as to presentment of truncated cheque. The amendment, despite recognising electronic image of a truncated cheque, has made provision for the drawee bank to call for the truncated cheque in original if it is not satisfied about the instrument.

Section 64(2)* stipulates, where an electronic image of a truncated cheque is presented for payment, the drawee bank is entitled to demand any further information regarding the truncated cheque from the bank holding the truncated cheque in case of any reasonable suspicion about the genuineness of the apparent tenor of instrument, and if the suspicion is that of any fraud, forgery, tampering or destruction of the instrument, it is entitled to further demand the presentment of the truncated cheque itself for verification:

Provided that the truncated cheque so demanded by the drawee bank shall be retained by it, if the payment is made accordingly.

Presentment for Payment when Excused

No presentment is necessary and the instrument may be treated as dishonoured in the following cases:

(a) Where the maker, drawer or acceptor actively does something so as to intentionally obstruct the presentment of the instrument, e.g., deprives the holder of the instrument and keeps it after maturity.

(b) Where his business place is closed on the due date.

(c) Where no person is present to make payment at the place specified for payment.

(d) Where he cannot, after due search be found. (Section 61)

(e) Where there is a promise to pay notwithstanding non-presentment.

(f) Where the presentment is express or impliedly waived by the party entitled to presentment.

(g) Where the drawer could not possibly have suffered any damage by non-presentment.

(h) Where the drawer is a fictitious person, or one incompetent to contract.

(i) Where the drawer and the drawee are the same person.

(j) Where the bill is dishonoured by non-acceptance.

(k) Where presentment has become impossible, e.g., the declaration of war between the countries of the holder and drawee.

(l) Where though the presentment is irregular, acceptance has been refused on some other grounds.

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* Inserted by the Amendment Act, 2002.

Dishonour by Non-Acceptance

Section 91 provides that a bill is said to be dishonoured by non-acceptance:

(a) When the drawee does not accept it within 48 hours from the time of presentment for acceptance.

(b) When presentment for acceptance is excused and the bill remains unaccepted.

(c) When the drawee is incompetent to contract.

(d) When the drawee is a fictitious person or after reasonable search can not be found.

(e) Where the acceptance is a qualified one.

Dishonour by Non-payment (Section 92)

A promissory note, bill of exchange or cheque is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same. Also, a negotiable instrument is dishonoured by non-payment when presentment for payment is excused and the instrument when overdue remains unpaid.

If the bill is dishonoured either by non-acceptance or by non-payment, the drawer and all the endorsers of the bill are liable to the holder, provided he gives notice of such dishonour. The drawee is liable only when there is dishonour by non-payment.

Notice of Dishonour (Sections 91-98 and Sections 105-107)

When a negotiable instrument is dishonoured either by non-acceptance or by non-payment, the holder or some party liable thereon must give notice of dishonour to all other parties whom he seeks to make liable. Each party receiving notice of dishonour must in order to render any prior party liable to himself, give notice of dishonour to such party within a reasonable time after he has received it. The object of giving notice is not to demand payment but to whom the party notified of his liability and in case of drawer to enable him to protect himself as against the drawee or acceptor who has dishonoured the instrument issued by him. Notice of dishonour is so necessary that an omission to give it discharges all parties other than the maker or acceptor. These parties are discharged not only on the bill or note, but also in respect of the original consideration.

Notice may be oral or in writing, but it must be actual formal notice. It must be given within a responsible time of dishonour.

Notice of Dishonour Unnecessary

No notice of dishonour is necessary:

(a) When it is dispensed with or waived by the party entitled thereto, e.g., where an endorser writes on the instrument such words as “notice of dishonour waived”,

(b) When the drawer has countermanded payment.

(c) When the party charged would not suffer damage for want of notice.

(d) When the party entitled to notice cannot after due search be found.

(e) When the omission to give notice is caused by unavoidable circumstances, e.g., death or dangerous illness of the holder.

(f) Where the acceptor is also a drawer, e.g., where a firm draws on its branch.
(g) Where the promissory note is not negotiable. Such a note cannot be endorsed.
(h) Where the party entitled to notice promises to pay unconditionally.

Noting and Protest (Sections 99-104 A)

Noting

Where a note or bill is dishonoured, the holder is entitled after giving due notice of dishonour, to sue the drawer and the endorsers. Section 99 provides a convenient method of authenticating the fact of dishonour by means of "Noting". Where a bill or note is dishonoured, the holder may, if he so desires, cause such dishonour to be noted by a notary public on the instrument, or on a paper attached thereto or partly on each. The noting or minute must be recorded by the notary public within a reasonable time after dishonour and must contain the fact of dishonour, the date of dishonour, the reason, if any, assigned for such dishonour if the instrument has not been expressly dishonoured the reasons why the holder treats it dishonoured and notary's charges.

Protest

The protest is the formal notarial certificate attesting the dishonour of the bill, and based upon the noting which has been effected on the dishonour of the bill. After the noting has been made, the formal protest is drawn up by the notary and when it is drawn up it relates back to the date of noting.

Where the acceptor of a bill has become insolvent, or has suspended payment, or his credit has been publicly impeached, before the maturity of the bill, the holder may have the bill protested for better security. The notary public demands better security and on its refusal makes a protest known as "protest for better security".

Foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn. Foreign promissory notes need not be so protested. Where a bill is required by law to be protested, then instead of a notice of dishonour, notice of protest must be given by the notary public.

A protest to be valid must contain on the instrument itself or a literal transcript thereof, the names of the parties for and against whom protest is made, the fact and reasons for dishonour together with the place and time of dishonour and the signature of the notary public. Protest affords an authentic evidence of dishonour to the drawer and the endorsee.

Discharge

The discharge in relation to negotiable instrument may be either (i) discharge of the instrument or (ii) discharge of one or more parties to the instrument from liability.

Discharge of the Instrument

A negotiable instrument is discharged:

(a) by payment in due course;
(b) when the principal debtor becomes the holder;
(c) by an act that would discharge simple contract;
(d) by renunciation; and

(e) by cancellation.

Discharge of a Party or Parties

When any particular party or parties are discharged, the instrument continues to be negotiable and the undischarged parties remain liable on it. For example, the non-presentment of a bill on the due date discharges the endorsers from their liability, but the acceptor remains liable on it.

A party may be discharged in the following ways :

(a) *By cancellation* by the holder of the name of any party to it with the intention of discharging him.

(b) *By release*, when the holder releases any party to the instrument

(c) *Discharge* of secondary parties, i.e., endorsers.

(d) *By the operation* of the law, i.e., by insolvency of the debtor.

(e) *By allowing* drawee more than 48 hours to accept the bill, all previous parties are discharged.

(f) *By non-presentment* of cheque promptly the drawer is discharged.

(g) *By taking qualified* acceptance, all the previous parties are discharged.

(h) By material alteration.

44. Material Alteration (Section 87)

An alteration is material which in any way alters the operation of the instrument and the liabilities of the parties thereto. Therefore, any change in an instrument which causes it to speak a different language in legal effect from that which it originally spoke, or which changes legal character of the instrument is a material alteration.

A material alteration renders the instrument void, but it affects only those persons who have already become parties at the date of the alteration. Those who take the altered instrument cannot complain. Section 88 provides that an acceptor or endorser of a negotiable instrument is bound by his acceptance or endorsement notwithstanding any previous alteration of the instrument.

Examples of material alteration are:

Alteration (i) of the date of the instrument (ii) of the sum payable, (iii) in the time of payment, (iv) of the place of payment,(v) of the rate of interest, (vi) by addition of a new party, (vii) tearing the instrument in a material part.

There is no material alteration and the instrument is not vitiated in the following cases:

(i) correction of a mistake, (ii) to carry out the common intention of the parties, (iii) an alteration made before the instrument is issued and made with the consent of the parties, (iv) crossing a cheque, (v) addition of the words “on demand” in an instrument where no time of payment is stated.

Section 89 affords protection to a person who pays an altered note bill or cheque. However, in order to be able to claim the protection, the following conditions must be fulfilled:

(i) the alteration should not be apparent;
(ii) the payment must be made in due course; and
(iii) the payment must be by a person or banker liable to pay.

Section 89 has been amended to provide for the amendment in the definition of cheque so as to provide for electronic image of a truncated cheque. The section provides that any bank or a clearing house which receives a transmitted electronic image of a truncated cheque, shall verify from the party who transmitted the image to it, that the image so transmitted to it and received by it, is exactly the same. Where there is any difference in apparent tenor of such electronic image and the truncated cheque, it shall be a material alteration. In such a case, it shall be the duty of the bank or the clearing house, as the case may be, to ensure the exactness of the apparent tenor of electronic image of the truncated cheque while truncating and transmitting the image. If the bank fails to discharge this duty, the payment made by it shall not be regarded as good and it shall not be afforded protection.*

Retirement of a Bill under Rebate

An acceptor of a bill may make payment before maturity, and the bill is then said to be retired, but it is not discharged and must not be cancelled except by the acceptor when it comes into his hands. It is customary in such a case to make allowance of interest on the money to the acceptor for the remainder of the time which the bill has to run. The interest allowance is known as rebate.

Hundis

Hundis are negotiable instruments written in an oriental language. They are sometimes bills of exchange and sometimes promissory notes, and are not covered under the Negotiable Instruments Act, 1881. Generally, they are governed by the customs and usages in the locality but if custom is silent on the point in dispute before the Court, this Act applies to the hundis. The term “hundi” was formerly applicable to native bills of exchange. The promissory notes were then called “teep”. The hundis were in circulation in India even before the present Negotiable Instrument Act, 1881 came into operation. The usages attached to these hundis varied with the locality in which they were in circulation.

Generally understood, the term “hundi” includes all indigenous negotiable instruments whether they are bills of exchange or promissory notes. An instrument in order to be a hundi must be capable of being sued by the holder in his own name, and must by the custom of trade be transferred like cash by delivery. Obviously the customs relating to hundis were many. In certain parts of the country even oral acceptance was in vague.

The following types of hundis are worth mentioning :

1. Shah Jog Hundi

“Shah” means a respectable and responsible person or a man of worth in the bazar. Shah Jog Hundi means a hundi which is payable only to a respectable holder, as opposed to a hundi payable to bearer. In other words the drawee before paying the same has to satisfy himself that the payee is a ‘SHAH’.

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* Inserted by the Amendment Act, 2002.

2. Jokhmi Hundi

A "jokhmi" hundi is always drawn on or against goods shipped on the vessel mentioned in the hundi. It implies a condition that money will be paid only in the event of arrival of the goods against which the hundi is drawn. It is in the nature of policy of insurance. The difference, however, is that the money is paid before hand and is to be recovered if the ship arrives safely.

3. Jawabee Hundi

According to Macpherson, "A person desirous of making a remittance writes to the payee and delivers the letter to a banker, who either endorses it on to any of his correspondents near the payee's place of residence, or negotiates its transfer. On the arrival, the letter is forwarded to the payee, who attends and gives his receipt in the form of an answer to the letter which is forwarded by the same channel of the drawer or the order." Therefore, this is a form of hundi which is used for remitting money from one place to another.

4. Nam jog Hundi

It is a hundi payable to the party named in the bill or his order. The name of the payee is specifically inserted in the hundi. It can also be negotiated like a bill of exchange. Its alteration into a Shah Jog hundi is a material alteration and renders it void.

5. Darshani Hundi

This is a hundi payable at sight. It is freely negotiable and the price is regulated by demand and supply. They are payable on demand and must be presented for payment within a reasonable time after they are received by the holder.

6. Miadi Hundi

This is otherwise called *muddati* hundi, that is, a hundi payable after a specified period of time. Usually money is advanced against these hundis by shroffs after deducting the advance for the period in advance. There are other forms of hundis also like.

Dhani Jog Hundi - A hundi which is payable to "dhani" i.e., the owner.

Firman Jog Hundi - which is payable to order if can be negotiated by endorsement and delivery.

Presumptions of Law

A negotiable instrument is subject to certain presumptions. These have been recognised by the Negotiable Instruments Act under Sections 118 and 119 with a view to facilitate the business transactions. These are described below:

It shall be presumed that:

(1) Every negotiable instrument was made or drawn for consideration irrespective of the consideration mentioned in the instrument or not.

(2) Every negotiable instrument having a date was made on such date.

(3) Every accepted bill of exchange was accepted within a reasonable time before its maturity.

(4) Every negotiable instrument was transferred before its maturity.

(5) The instruments were endorsed in the order in which they appear on it.

(6) A lost or destroyed instrument was duly signed and stamped.

(7) The holder of the instrument is a holder in due course.

(8) In a suit upon an instrument which has been dishonoured, the Court shall presume the fact of dishonour, or proof of the protest.

However these legal presumptions are rebuttable by evidence to the contrary. The burden to prove to the contrary lies upon the defendant to the suit and not upon the plaintiff.

Payment of Interest in case of dishonour

The Negotiable Instruments Act, 1881 was amended in the year 1988, revising the rate of interest as contained in Sections 80 and 117, from 6 per cent to 18 per cent per annum payable on negotiable instruments from the due date in case no rate of interest is specified, or payable to an endorser from the date of payment on a negotiable instrument on its dishonour with a view to discourage the withholding of payment on negotiable instruments on due dates.

Penalties in case of dishonour of cheques

Chapter XVII of the Negotiable Instruments Act provides for penalties in case of dishonour of certain cheques for insufficiencies of funds in the accounts. Sections 138 to 147 deal with these aspects.

Chapter XVII has been amended by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002. The amendments have provided the drawer with more time to send notice, made the punishment for the offence more stringent, given power to court for condonation of delay in filing of complaint, excluded liability of government nominated directors, made provision for summary trial of cases under the Chapter and time bound disposal of cases, have relaxed the rules of evidence, and made the offences under the Act compoundable.

The working of the provisions of Chapter XVII for a period of more than a decade had brought to the fore front various lacunae and shortcomings from which it suffered. It was seen that there were enormous delays in the disposal of the cases filed under Section 138 and the drawer of the cheques, by taking shield of various technicalities and procedures were frustrating the very object of the Chapter.

The provisions contained in this Chapter provide that where any cheque drawn by a person for discharge of any liability is returned by the bank unpaid for the reason of insufficiency of the amount of money standing to the credit of the account on which the cheque was drawn or for the reason that it exceeds the arrangement made by the drawer of the cheque with the banker for that account, the drawer of such cheque shall be deemed to have committed an offence. In that case, the drawer, without prejudice to the other provisions of the Act, shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to twice the amount of the cheque, or with both.

In order to constitute the said offence

(a) such cheque should have been presented to the bank within a period of six months from the date on which it is drawn or within the period of its validity, whichever is earlier; and

(b) the payee or holder in due course of such cheque should have made a demand for the payment of the said amount of money by giving notice, in writing, to the drawer of the cheque within thirty days of the receipt of information by him from the bank regarding the return of the cheque unpaid; and

(c) the drawer of such cheque should have failed to make the payment of the said amount of money to the payee or the holder in due course of the cheque within fifteen days of the receipt of the said notice.

It has also been provided that it shall be presumed, unless the contrary is proved, that the holder of such cheque received the cheque in the discharge of a liability. Defences which may or may not be allowed in any prosecution for such offence have also been provided to make the provisions effective. The Supreme Court in *Modi Cements Ltd.* v. *K.K. Nandi, (*1988) 28 CLA 491, held that merely because the drawer issued a notice to the drawee or to the Bank for 'stop payment', it would not preclude an action under Section 138 by the drawee or holder in due course.

The liability of government nominated directors has been excluded under Section 141 of the Act dealing with 'offences by companies'. The second proviso inserted in Section 141 by the Amendment Act, 2002 provides that where a person is nominated as a director of a company by virtue of his holding any office or employment in the Central Government or State Government or a financial corporation owned or controlled by the Central Government or the State Government, as the case may be, he shall not be liable for prosecution under this Chapter. In order to ensure that genuine and honest bank customers are not harassed or put to inconvenience, sufficient safeguards have also been provided in the new Chapter, as under:

(a) that no court shall take cognizance of such offence except on a complaint in writing, made by the payee or the holder in due course of the cheque;

(b) that such complaint is made within one month or the date on which the cause of action arises;

*Provided that the cognizance of a complaint may be taken by the court after the prescribed period, if the complainant satisfies the court that he had sufficient cause for not making the complaint within such period.

(c) that no court inferior to that of a Metropolitan Magistrate or a Judicial magistrate of the first class shall try any such offence. (Section 142)

Moreover, the new Sections inserted by the Amendment Act, 2002 provide that all offences under this Chapter shall be tried by a Judicial Magistrate of the first class or by a Metropolitan Magistrate and the provisions of Sections 262 to 265 (both inclusive) of the said Code shall, as far as may be, apply to such trials:

Provided that in the case of any conviction in a *summary trial* under this Section, it shall be lawful for the Magistrate to pass a sentence of imprisonment for a term not exceeding one year and an amount of fine exceeding five thousand rupees:

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* Inserted by the Amendment Act, 2002.

Provided further that when at the commencement of, or in the course of, a summary trial under this Section, it appears to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Magistrate shall, after hearing the parties, record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear the case in the manner provided by the said Code.

(2) The trial of a case under this Section shall, so far as practicable, consistently with the interests of justice, be continued from day to day until its conclusion, unless the court finds the adjournment of the trial beyond the following day to be necessary for reasons to be recorded in writing.

(3) Every trial under this Section shall be conducted as expeditiously as possible and an endeavour shall be made to conclude the trial within six months from the date of filing of the complaint. (Section 143)

A Magistrate issuing a summons to an accused or a witness may direct a copy of summons to be served at the place where such accused or witness ordinarily resides or carries on business or personally works for gain, by speed post or by such courier services as are approved by a Court of Session.

Where an acknowledgement purporting to be signed by the accused or the witness or an endorsement purported to be made by any person authorised by the postal department or the courier services that the accused or the witness refused to take delivery of summons has been received, the court issuing the summons may declare that the summons has been duly served. (Section 144)

The evidence of the complainant may be given by him on affidavit and may, subject to all just exceptions be read in evidence in any enquiry, trial or other proceeding under the said Code.

The court may, if it thinks fit, and shall, on the application of the prosecution or the accused, summon and examine any person giving evidence on affidavit as to the facts contained therein. (Section 145)

The court shall, in respect of every proceeding under this Chapter, on production of bank's slip or memo having thereon the official mark denoting that the cheque has been dishonoured, presume the fact of dishonour of such cheque, unless and until such fact is disproved. Every offence punishable under this Act shall be compoundable. (Sections 146 and 147)

The practical effect of these amendments which have only recently been brought into force would be seen with time to come but it is expected that they would go a long way in making the remedy provided for by Chapter XVII meaningful and effective.

SELF-TEST QUESTIONS

1. Define negotiable instrument. Make a distinction between a Bill and a Cheque.
2. Discuss the provisions relating to paying banker and what is meant by

payment in due course?

3. What is crossing of a cheque? Discuss various modes of crossing of a cheque.
4. What is hundi? Describe some of the important hundis.
5. Write short notes on following:
   (i) Accommodation Bill.
   (ii) Holder-in-due course.
   (iii) Endorsement.
   (iv) Inland and foreign instruments.
   (v) Stale cheque.
6. Describe legal presumption in case of negotiable instruments.
7. Discuss the penal provisions in case of dishonour of cheque?
8. A draws a bill payable three months after sight on B. It passes several hands before X becomes its holder on presentation by X, B refuses to accept the bill. Discuss the rights of X.
9. Tick (✓) mark for the right answer:
   (a) A negotiable instrument is freely transferable. Yes/No.
   (b) A bill of exchange must be in writing. Yes/No.
   (c) There must always be three different parties in a bill of exchange. Yes/No.
   (d) Forgery of drawers' signatures ordinarily does not protect the paying bank. Yes/No.
   (e) 'Holder' and 'Holder in Due Course' carry the same meaning. Yes/No.

Suggested Readings:

(1) The Negotiable Instruments Act, 1881 — *Bare Act*
(2) A Manual of Merchantile Law — *M.C. Shukla*
(3) Negotiable Instruments Act — *Khergamwala*
(4) The Negotiable Instruments Act — *Bhashyam & Adiga* (Revised by *J.C. Verma*, Bharat Law House Pvt. Ltd., New Delhi)

STUDY V

INDIAN PARTNERSHIP ACT, 1932

Nature of Partnership

The Indian Partnership Act, 1932 lays down the important provisions relating to partnership contracts. However, the general principles of the Indian Contracts Act, 1872 which formally contained the provisions of the law of partnership shall apply so far as they are not inconsistent with this Act. (Section 3)

Definitions

Partnership

According to Section 4 "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

When analysed, the definition tells us that in order that persons may become partners, it is essential that:

(1) There must be at least two persons;

(2) There must be a relationship arising out of an agreement between two or more persons to do a business;

(3) The agreement must be to share the profits of a business;

(4) The business must be carried on by all or any of them acting for all.

All these four elements must be present before a group or an association can be held to be partners. In other words, it can be said that all the aforestated four elements must co-exist before a partnership can be said to come into existence. If any one of them is not proved to be present, there cannot be a partnership. The first element relates to the voluntary contractual nature of partnership; the second gives the motive which leads to the formation of firms, i.e. the acquisition of gains; the third shows that the persons of the group who conduct the business do so as agents for all the persons in the group, and are therefore liable to account to all the persons in the group (*Maliram Choudhary* v. *Jagannath*, AIR 1972 Orissa 17).

Partners, Firm and Firm Name

Persons who have entered into partnership with one another are called individually "partners" and collectively "a firm", and the name under which their business is carried on is called the "firm name". (Section 4)

In law, "a firm" is only a convenient phrase for describing the partners, and the firm has no legal existence apart from its partners. It is neither a legal entity, nor is it a person as is a corporation; it is a collective name of the members of a partnership.

As regard the "firm name", partners have a right to carry on business under any name and style which they choose to adopt, provided they do not violate the rules relating to trade name or goodwill. They must not adopt name calculated to mislead the public into confusing them with a firm of repute already in existence with a similar

name. They must not use a name implying the sanction of patronage of the Government. A partnership firm cannot use the word “Limited” as a part of its name.

Essentials of a Partnership and True Test of Partnership

These elements are discussed below in detail:

(1) Association of two or more persons

There must be a contract between two or more persons. Therefore unless there are at least two persons there can not be a partnership. Persons must be competent to enter into a contract. They may all be natural or artificial or some natural and other artificial. Thus a corporation or limited partnership may itself be a partner in a general partnership.

(2) Agreement

Existence of an agreement is essential of partnership. Section 5 of the Act states that the relation of partnership arises from contract and not from status; and in particular, the members of a Hindu Undivided Family carrying on a family business as such, or a Burmese Buddhist Husband and wife carrying on business as such are not partners in such business.

Such an agreement between the partners may be express or implied. Further, the agreement must be a valid agreement and for a lawful object and purpose and between the persons competent to contract.

(3) Business

Partnership implies business and when there is no association to carry on business there is no partnership. The term “business” is, however, used in the widest sense to cover trade, occupation and profession. As per Section 2(b) of the Act the term “business” includes every trade, occupation and profession. In the definition of partnership the word “business” is used in the sense of “carrying on business” which suggests continuity or repetition of acts. But it does not mean that it should be confined to lengthy operations, it may consist of a single adventure of a single undertaking, if there is continued participation of two or more persons for acquisition of gains.

The term must be understood in a particular sense . It refers to any activity which, if successful, would result in profit.

(4) Sharing of Profits

To constitute a partnership, the parties must have agreed to carry on a business and to share profits in common. “Profits” mean the excess of returns over advances, the excess of what is obtained over the cost of obtaining it. Sharing of profits also involves sharing of losses. But whereas the sharing of profit is an essential element of partnership, the sharing of losses is not. It is open to one or more partners to bear all the losses of the business.

It follows that the sharing of profits is an essential ingredient of partnership and there would be no partnership where only one of the partners is entitled to the whole of the profits of the business. But it is open to the partners to agree to share the

profits in any way they like. They may agree to share the profits either in specific proportions or in specific sums. There is nothing to stop a partner from agreeing to receive a fixed annual or monthly amount “by way of profits” irrespective of whether profits are earned or not.

Sharing of Profits is not Conclusive

Test Although sharing of profits is a prima facie evidence of the existence of partnership, this is not the conclusive test of the same. A person may have a share in the partnership profits, but still may not be a partner. For instance, a joint owner of a property sharing its return or members of non-profit or non-trading associations will not be called partners.

Illustrations

1. A and B buy 100 bales of cotton, which they agree to sell for their joint account, each party sharing profits and bearing losses equally. A and B are partners in respect of such account.
2. A and B buy 100 bales of cotton agreeing to divide these between them. A and B are not partners.
3. “A” a trader, owed money to XY&Z. He agreed to pay XY&Z out of the profits of his business (run under the supervision of X, Y and Z) what he owned to them.

It was held that the arrangement does not make X, Y and Z the partners with A in the business.

(5) Mutual AgencyThe True Test

Mutual agency is the foundation of partner’s liability. Each partner is both an agent and principal for himself and others; that is the significance of the phrase “carried on by all or any of them acting for all”. Each partner is an agent binding the other partners who are his principal and each partner is again a principal, who in turn is bound by the acts of the other partners. In other words, there must be facts or circumstances from which it can be inferred that each of the persons alleged to be partners was the agent, real or implied of another. What is essential is that the partner who conducts the business of the firm not only acts for himself but for the other partners also.

The true test, therefore, in determining whether a partnership exists, is to see whether the relation of principal and agent exists between the parties and not merely whether the parties share the profits or the business is carried on for the benefit of all. It is this relation of agency among partners which distinguishes a partnership from a single co-ownership on the one hand and the agreement to share profits on the other. The existence of this relation of agency can be gathered from the real intention of the parties and the circumstances of the case. The question of intention must be decided on the basis of the conduct of parties and of all the surrounding circumstances.

The partners finding themselves in financial difficulties assigned their properties to creditors trustees for carrying on the business and paying off their debts out of the income of the business. The trustees incurred certain liabilities and the creditors brought action against trustees seeking to make them personally liable on these contracts. The House of Lords held that they were not liable. Mere sharing of profits

is not a conclusive test of partnership. “The real test is whether the trade was carried on his behalf, i.e., he stood in the relation of principal towards the persons acting ostensibly as the traders, by whom the liability has been incurred and under whose management the profits have been made”.

It may be observed that the question whether a person is or is not a partner depends almost in all cases upon whether he has the authority to act for other partners and whether other partners have the authority to act for him. It follows that the agency relationship is the most important test of partnership.

Formation of Partnership

According to the definition of partnership under the Indian Partnership Act, there must be an agreement between the partners of a partnership firm.

The partnership agreement must comply with all the essentials of a valid contract. There must be free consent of the parties who must be competent to contract and the object of partnership should not be forbidden by law or immoral or opposed to public policy. Two exceptions, however, may be noted:

(i) A minor may be admitted to the benefits of a partnership with the consent of all other partners.

(ii) As relations of partners inter se are that of agency, no consideration is required to create the partnership.

Partnership Deed

The agreement of partnership may be oral but to avoid future disputes it is always advisable to have it in writing. The mutual rights and obligations of partners must be discussed in detail and should be put into writing in the shape of a ‘Partnership Deed’, before the partnership is actually started. (The partnership deed is also called as ‘Partnership Agreement’, ‘Constitution of Partnership’, ‘Articles of Partnership’ etc.). The deed must be property drafted and stamped according to the provisions of the Indian Stamp Act. Each partner should be given a copy of the deed and if the firm is to be registered, a copy of the deed should be filed with the Registrar of Firms at the time of such legislation.

Contents of Partnership Deed

The exact terms of the partnership deed (or agreement) will depend upon the circumstances but generally a partnership deed contains the following covenants: (i) The firm name and business to be carried on under that name. (ii) Names and addresses of partners. (ii) Nature and scope of business and address(s) of business place(s). (iv) Commencement and duration of partnership. (v) The capital and the contribution made by each partner. (vi) Provision for further capital and loans by partners to the firm. (vii) Partner’s drawings. (viii) Interest on capital, loans, drawings and current account. (ix) Salaries, commission and remuneration to partners, (x) Profit (or loss) sharing ratio of partners. (xi) The keeping of proper books of

accounts, inspection and audit, Bank Accounts and their operation. (xii) The accounting period and the date on which that accounts are to be prepared. (xiii) Rights, powers and duties of the partners. (xiv) Whether and in what circumstances, notice of retirement or dissolution can be given by a partner. (xv) Provision that death or retirement of a partner will not bring about dissolution of partnership, (xvi) Valuation of goodwill on retirement, death, dissolution etc. (xvii) The method of valuation of assets (and liabilities) on retirement or death of any partner. (xviii) Provision for expulsion of a partner. (xix) Provision regarding the allocation of business activities to be performed by individual partners. (xx) The arbitration clause for the settlement of disputes. The terms contained in the partnership deed may be varied with the consent of all the parties, and such consent may be express or implied by a course of dealing. [Section 11(1)]

Classification of Partnership

A partnership may either be for a particular adventure or for a fixed period. It may also be a partnership at will. From the duration point of view, a partnership may be classified into the following two categories:

(i) Particular Partnership (Section 8)

"A person may become a partner with another person in a particular adventure or undertaking". When two or more persons agree to do business in a particular adventure or undertaking, such a partnership is called "Particular Partnership". Thus, a particular partnership may even be for a single adventure or undertaking.

(ii) Partnership at Will (Section 7)

"Where no provision is made by contract between the partners for the duration of their partnership or for the determination of their partnership, the partnership is called Partnership at Will". A partnership is deemed to be a partnership at will when (i) no fixed period has been agreed upon for the duration of partnership, and (ii) there is no provision made as to the determination of partnership in any other way. The partnership at will has no fixed or definite date of termination and, therefore, death or retirement of a partner does not affect the existence of such partnership.

Section 43(1) provides that "Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm. The firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no such date is mentioned, as from the date of communication of the notice". This accounts for the importance of the definition of 'Partnership at Will'.

Co-ownership and Partnership

There is a possibility that two co-owners may employ their property in a business and share the profits, and still be not partners. A distinction between the two is in point. Partnership is between two persons but not more than 20 (10 in the case of banks) co-ownership may have two or any number more than two. Co- ownership is not always the result of an agreement: it may arise by the operation of law or from status, e.g., co-heirs of a property. Partnership must arise from an agreement. A

partner is the agent of the other partners, but a co-owner is not the agent of the other co-owner(s). Co-ownership does not necessarily involve community of profits and loss, partnership does. A co- owner can without the consent of the others transfer his rights and interests to strangers, a partner cannot do so without the consent of all the other partners so as to make the transferee a partner in the firm. A co-owner can ask for division of property in specie, but no partner can ask for this. His only right is to have a share of the profits out of the properties. Partnerships end at death or insolvency; co-ownerships end at death. A co-owner has no lien on the property while a partner has a lien on the firm property.

Hindu Joint Family Firm and Partnership

A Hindu joint family firm differs from a partnership in the following ways:

A partnership comes into existence by means of a contract between the partners; a Hindu joint family firm arises as a result of status, i.e., by birth in the family. The death of a partner dissolves the partnership, but the death of a co-parcener does not dissolve the family firm. In a joint family firm only the Karta or manager (who is the head of the family) has implied authority to borrow and bind other members; in a partnership each partner is entitled to do so. Every partner is personally liable for the debts of the firm; in a joint family business only the Karta is personally liable. A minor is a member of a joint family firm from the very day of his birth by virtue of his status, but he is not personally liable. A minor cannot be a partner, although he may be admitted to the benefits of partnership. A partner can demand the accounts of the firm, a co-parcener cannot ask for accounts, his only remedy is to ask for partition of the assets of the family firm. No registration of a family firm is necessary, while a partnership firm must be registered before it can maintain suits against outsiders. Each partner has a definite share in the business and this can be changed only by agreement, but the share of a co-parcener is not fixed; it may be enlarged by death or reduced by a birth in the family. There is a definite limit to the number of partners, but there is no such limit in the case of a Hindu joint family firm. A Hindu joint family business is governed by Hindu Law, while Indian Partnership Act, governs partnerships and excludes Hindu joint family firms. (Section 5)

Company and Partnership

The members constituting a partnership do not form a whole as distinct from the individuals composing it. The firm has no legal entity and has no rights and obligations separate from the partners. In a firm every partner is an agent of the rest of the partners, but a member of a company is neither the agent of the company nor of other members. A company, as soon as it is incorporated, say by registration under the Companies Act, becomes a legal entity distinct from its members constituting it (*Salomon* v. *Salomon & Co.,* 1897, A.C. 22). It can sue and be sued in its own name like any natural person. In a partnership, there are rights and obligations as against individual partners, but in the case of a company, the rights and obligations are as against the fictitious entity of the whole of the company and not the members composing it. The creditors of the partnership can call upon

individual partners to pay the firm's debt, but the members of a company are not personally liable for the company's debts. In other words, a partner's liability is unlimited while the liability of the members of a company is limited to the extent of the amount remaining unpaid on their shares (*Prasad* v. *Missir*). Partnership firm may dissolve by the death or insolvency of a partner, but a company is not affected by the death or insolvency of a member. A partner cannot transfer his interest so as to substitute the transferee in his place as the partner, without the consent of all the other partners; a member can transfer his share to any one he likes. The maximum number of partners for a banking firm is 10 and for other firms it is 20, while the maximum number of members for a private company is 50 and a public company can have any number of members.

Change in a Firm

The Indian Partnership Act, 1932, contemplates the following changes in a partnership firm:

(1) Changes in the constitution of a firm.

(2) Changes in the nature of a business or undertakings.

(3) Changes in the duration of a firm.

A change in the constitution of a firm takes place when:

(a) a new partner is introduced as a partner in a firm; (Section 31)

(b) a partner retires from a firm; (Section 32),

(c) a partner is expelled from a firm; (Section 33),

(d) a partner is adjudicated as an insolvent; (Section 34) and

(e) a partner dies. (Section 35)

A change in the nature of the business can only be brought about by the consent of all the partners. Thus, a partnership formed for a definite purpose, agreed upon at the time of formation of the partnership, cannot depart from the agreed purpose without the consent of all the partners [Section 12(c)]. Section 17(c)provides for a case whether a partnership firm is formed for a particular undertaking or undertakings, it proceeds to carry on other undertaking or undertakings, in that event the mutual rights and duties of the partners in respect of the other adventures or undertakings are the same as those in respect of the original adventures of undertakings.

Partnership Property

It is open to the partners to agree among themselves as to what is to be treated as the property of the firm, and what is to be separate property of one or more partners, although employed for the purposes of the firm. In the absence of any such agreement, express or implied, the property of the firm is deemed to include:

(a) all property, rights and interests which have been brought into the common stock for the purposes of the partnership by individual partners, whether at the commencement of the business or subsequently added thereto;

(b) those acquired in the course of the business with money belonging to the firm; and

(c) the goodwill of the business. (Section 14)

The property of the firm belongs to the firm and not to the individual partner or partners. The ownership belongs to the firm, and no partner can deal with specific properties as if the properties are his own, nor does the partner possess any assignable interest in such property (*Narayanappa* v. *Bhaskaia Krishnappa,* AIR 1966 SC 1300). What is meant by the share of a partner is his proportion of the partnership assets after they are all realised and converted into money, and all the partnership debts and liabilities have been paid and discharged. If certain partners jointly own immovable property which they use for the purposes of the partnership business, the mere use of such property does not make such property as partnership property. Whether such property is or is not partnership property depends upon the agreement between the partners (*Lachhman Dass* v. *Mrs. Gulab Devi,* AIR 1936 ALL. 270). The ultimate test to determine the property of the firm is the real intention of the partners and the Court can take into consideration the following facts:

(1) The source of the purchase money.

(2) The reason due to which the property was purchased or acquired.

(3) The object for which the property was purchased or acquired.

(4) The mode in which the property was obtained.

(5) The mode in which the property was dealt with.

(6) The use to which the property was put to.

All such facts are matter of evidence and depend on the facts of each case. These facts indicate the intention of the parties but are not conclusive to make a property as partnership property. These facts can be established by entries in the books of account of the firm and of the partners, correspondence, the deed of partnership, etc.

Kinds of Partners

The following kinds of partners generally exist in a partnership:

(i) Actual, Active or Ostensible Partner

These are the ordinary types of partners who invest money into the business of the firm, actively participate in the functioning and management of the business and share its profits or losses. Section 12(a) lays down that “Subject to contract between the partners, every partner is entitled to take part in the conduct of the business of the firm”. Such partner as actively participates in the firm’s business, binds himself and other partners by all his acts done in the usual course of partnership business. Such partner must give a public notice of his retirement from the firm in order to absolve (free) himself from liability for the acts of the other partners done after his retirement.

(ii) Sleeping or Dormant Partner

These partners invest money in the firm’s business and take their share of profits but do not participate in the functioning and management of the business. But even then their liability is unlimited. The Act specially provides that if an act is binding on the firm, every partner is liable for it.

A sleeping partner can retire from the firm without giving any public notice to this

effect. His liability for the acts of the firm ceases soon after retirement. Such partner has no duties to perform but is entitled to have access to books and accounts of the firm and he can have a copy of them.

(iii) Nominal Partner

Some people do not invest or participate in the management of the firm but only give their name to the business or firm. They are nominal partners but are liable to third parties for all the acts of the firm. Unlike a sleeping partner, they are known to the outsiders as partners in the firm, whereas actually they are not.

(iv) Partner in Profits Only

A partner who is entitled to share in the profits of a partnership firm without being liable to share the losses, is called a partner in profits only. Thus, a person who has sufficient capital but is not prepared to take risk may be admitted to the partnership by the other partners. Inspite of his specific position, he continues to be liable to the third parties for all acts of the firm, just like other parties.

(v) Sub-Partner

Where a partner agrees to share his profits in the firm with a third person, that third person is called a sub-partner. Such a sub-partner has no rights or duties towards the firm and does not carry any liability for the debts of the firm. Also he cannot bind the firm or other partners by his acts.

(vi) Partner by Estoppel or Holding Out

If the behaviour of a person arouses misunderstanding that he is a partner in a firm (when actually he is not), such a person is estopped from later on denying the liabilities for the acts of the firm. Such person is called partner by estoppel and is liable to all third parties.

Similarly, if a person who is declared to be a partner (when actually he is not) does not deny the fact that he is a partner, he being held out as a partner is responsible for all liability of the business. The law relating to partners by holding out is contained in Section 28 of the Act which lays down thus:

"Any one who by words, spoken or written or by conduct represents himself, or knowingly permits himself to be represented to be a partner in a firm, is liable as a partner in that firm to any one who has on the faith of any such representation given credit to the firm, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit". The rule as to holding out is based on the doctrine of estoppel as contained in Section 115 of the Indian Evidence Act.

Holding Out means "to represent". Strangers, who hold themselves out or represent themselves to be partners in a firm, whereby they induce others to give credit to the partnership are called "Partners by Holding Out".

In case of "Partnership by Estoppel", the representation is made by partners about a stranger within his knowledge and hearing and he does not contradict it. He is then held liable as a partner.

Effects of Holding out

The Holding Out partner becomes personally and individually liable for the acts of the firm. But he does not become a partner in the firm and is not entitled to any rights or claim upon the firm. An outsider, who has given credit to the firm thinking him to be a partner, can hold him liable as if he is a partner in that firm. As the liability of the partners is joint and several he can be held liable to pay the entire amount. But under the doctrine of subrogation as well as on the basis of quasi-contract, he can recover the amount so paid from the partners of the firm, if they are solvent.

Exceptions to Holding Out

The doctrine of Holding Out is not applicable in the following cases:

1. It does not apply to cases of torts committed by partners. A person, therefore, cannot be held liable for the torts of another simply because that other person held himself to be his partner.

2. It does not extend to bind the estate of a deceased partner, where after a partner's death the business of the firm is continued in the old firm name. [Section 28(2)]

3. It also does not apply where the Holding Out partner has been adjudicated insolvent. (Section 45)

Minor Admitted to the Benefits of Partnership

In view of Section 11 of the Indian Contract Act, 1872, and the decision of the Privy Council in *Mohri Bibi* v. *Dharmo Das Ghose,* (1903) 30 I.A 114, a minor's agreement is altogether void and unenforceable. An agreement is an essential ingredient in a partnership, it follows that a minor cannot enter into an agreement of partnership. On the same principle, a minor cannot be clothed with all the rights and obligations of a full-fledged partner through a guardian. Section 5 states "The relation of partnership arises from a contract..." The minor is incompetent to contract and, therefore, partnership cannot come into existence if the parties to a contract of partnership consist of one major and one minor. The only provision that Section 30 makes is that with the "consent of all the partners for the time being, a minor can be admitted into the benefits of partnership to which a minor is going to be admitted". A partnership firm cannot be formed with only minors as partners. There must be atleast two major partners before a minor is admitted into the benefits of partnership.

Rights of Minor

He is entitled to his agreed share and can inspect books of account of the firm [Section 30(2)]. He can bring a suit for account and his share when he intends to sever his connections with the firm, but not otherwise. [Section 30(4)]

A minor who was admitted to the benefits during his minority within six months of his attaining the age of majority or when he comes to know of his being so admitted (whichever date is later), he has to elect whether he wants to become a partner, or sever his connection with the firm. He may give public notice of his election to

continue or repudiate, but if he fails to give any public notice within the period stated above, he will be deemed to have elected to become a partner in the firm. [Section 30(5)]

Liabilities of Minor

1. His Share in Liability

A minor partner's liability is confined only to the extent of his share in the firm. Section 30(3) provides that a minor's share is liable for the acts of the firm. But a minor is not personally liable in any such act. Thus, he is neither personally liable nor is his private estate liable for the acts of the firm.

2. Personal Liabilities

Where a minor on attaining majority, elects to become a partner, he becomes personally liable as other partners to the third parties for all the acts of the firm done since he was admitted to the benefits of partnership.

Election by Minor

A minor who was admitted to the benefits during his minority within six months of his attaining the age of majority or when he comes to know of his being so admitted (whichever date is later), he has to elect whether he wants to become a partner, or sever his connection with the firm. He may give public notice of his election to continue or repudiate, but if he fails to give any public notice within the period stated above, he will be deemed to have elected to become a partner in the firm. [Section 30(5)]

If he becomes or elects to become a partner, his position will be as under:

1. His rights and liabilities will be similar to those of a full-fledged partner.
2. He will be personally liable for all the acts of the firm, done since he was first admitted to the benefits of the partnership.
3. His share of profits and property remains the same as was before, unless altered by agreement.

If he elects not to become a partner, then:

1. His rights and liabilities shall continue to be those of a minor upto the date of his giving public notice.
2. His share shall not be liable for any acts of the firm done after the date of the public notice.
3. He is entitled to sue the partners for his share of the property and profits in the firm. [Section 30(8)]

Relation of Partners to one another

The relation of partnership arises through an agreement between the parties and such an agreement normally provides for mutual rights and obligations, or duties of the partners. Where, however, partnership arises by implication, or wherever the articles of partnership are silent, or where they do not exist, the rights and duties of partners are governed by the Act.

Rights of Partners

Unless otherwise agreed by the partners, the following rules apply:

(a) Every partner has a right to take part in the conduct and management of the business. [Section 12(a)]

(b) Every partner whether active or dormant, has a right of free access to all records, books and accounts of the business and also to examine and copy them. [Section 12(d)]

(c) Every partner is entitled to share in the profits equally, unless different proportions are stipulated. [Section 13(b)]

(d) A partner who has contributed more than the share of the capital for the purpose of the business is entitled to an interest at a rate agreed upon, and where no rate is stipulated for, at six per cent per annum. But a partner cannot claim interest on capital, unless there is an agreement to pay it. [Section 13(d)]

(e) A partner is entitled to be indemnified by the firm for all expenses incurred by him in the course of the business, for all payments made by him in respect of partnership debts or liabilities and disbursements made in an emergency for protecting the firm from loss. [Section 13(e)]

(f) Every partner is, as a rule, a joint owner of the partnership property, and have it applied exclusively for the purposes of the partnership. (Section 15)

(g) A partner has power to act in an emergency for protecting the firm from loss. (Section 21)

(h) Every partner is entitled to prevent the introduction of a new partner into the firm without his consent. (Section 31)

(i) Every partner has a right to retire by giving notice where the partnership is at will. [Section 32(1)(c)]

(j) Every partner has a right to continue in the partnership and not to be expelled from it. [Section 33(1)]

(k) An incoming partner will not be liable for any debts or liabilities of the firm before he becomes a partner. [Section 31(2)] (l)

(l) Every outgoing partner has a right to carry on a competitive business under certain conditions. (Section 36)

Duties of Partners

Apart from any duties imposed by the partnership articles, the following statutory duties are implied:

(a) Every partner is bound to carry on the business of the firm to the greatest common advantage. (Section 9)

(b) Every partner must be just and faithful to other partners. (Section 9)

(c) A partner is bound to keep and render true, proper and correct accounts of the partnership. (Section 9)

(d) Utmost good faith between the partners is the rule and one partner must not take advantage of the other. As an agent of other partners, every partner is bound to communicate full information to them. (Section 9)

(e) Every partner must account for any benefits derived from the partnership business without the consent of the other partners, i.e., a partner must not make "secret profits". [Section 16(a)]

(f) A partner must not compete with the firm, without the consent of the other partners. Any profits made by such unauthorised competition can be claimed by the firm. [Section 16(b)]

(g) Every partner is bound to attend diligently to the business of the firm and in the absence of any agreement to the contrary, he is not entitled to receive any remuneration. [Section 12(b) and 13(a)]

(h) In the absence of an agreement to the contrary, every partner is bound to share losses equally with the others. [Section 13(b)]

(i) Every partner must hold and use the partnership property exclusively for the firm. (Section 15)

(j) Every partner is bound to indemnify the firm for any loss caused by fraud in the conduct of the business. (Section 10)

(k) A partner who is guilty of wilful neglect in the conduct of the business and the firm suffers loss in consequence, is bound to make compensation to the firm and other partners. [Section 13(f)]

(l) No partner can assign or transfer his partnership interest to any other person, so as to make him a partner in the business. (Section 29)

(m) But a partner may assign the profits and share in the partnership assets. But the assignee or transferee will have no right to ask for the accounts or to interfere in the management of the business; he would be entitled only to share the actual profits. On dissolution of the firm, he will be entitled to the share of the assets and also to accounts but only from the date of dissolution. (Section 29)

(n) Every partner is bound to act within the scope of his actual authority. If he exceeds his authority, he shall compensate the other partners for loss unless they ratify his act.

Relation of Partners to Third Parties

Partners as Agents

Every partner is an agent of the firm and of other partners for the purpose of the business of the firm (Section 18). In the case of a partnership each partner is a principal and each one is an agent for the other partners. A partner is both a principal

and an agent. Thus, the general law of agency is incorporated into the law of partnership. The law of partnership is often regarded as branch of the law of agency. The acts of every partner who does any act for carrying on in the usual way the business of the kind carried on by the firm bind the firm and his partners unless:

(i) The partner so acting has no authority to act for the firm in that matter; and

(ii) The person with whom he is dealing knows that he has no authority; or

(iii) Does not know or believe him to be a partner.

Authority of a Partner

The authority of a partner means the capacity of a partner to bind the firm by his act. This authority may be express or implied.

Authority is said to be express when it is given by words, spoken or written. The firm is bound by all acts of a partner done within the scope of his express authority even if the acts are not within the scope of the partnership business.

The implied authority of a partner is also known as ostensible or apparent authority, Sections 19 and 22 contain provisions regarding the scope of the implied authority of a partner. The implied authority is subject to the following conditions:

(1) the act done must relate to the "normal business" of the firm;

(2) the act must be done in the usual way;

(3) the act must be done in the name of the firm.

Implied Authority of a Partner

Subject to the limitations mentioned above, every partner has an implied authority to bind the firm by the following acts:

(i) By selling firm's goods;

(ii) By purchasing goods for the firm;

(iii) By accepting any payment of debts due to the firm; and

(iv) By engaging and discharging employees.

In a Trading Firm (one which carries on business of buying and selling goods), a partner has the following additional powers:

(i) To borrow money on the firm's credit and to pledge the firm's goods for that purpose;

(ii) To accept, make and issue negotiable instruments in the firm's name; and

(iii) To employ a solicitor or attorney on behalf of the firm (*Bank of Australasia* v. *Beriliat,* (1847) 6 Moor, P.C. 152 at pp. 193-94).

No Implied Authority

Section 19(2) states that in the absence of any usage or custom or trade to the contrary, the implied authority of a partner does not empower him to:

(a) submit a dispute relating to the business of the firm to arbitration;

(b) open a banking account on behalf of the firm in his own name;

(c) compromise or relinquish any claim or portion of a claim by the firm;

(d) withdraw a suit or proceeding filed on behalf of the firm;

(e) admit any liability in a suit or proceedings against the firm;

(f) acquire immovable property on behalf of the firm;

(g) transfer immovable property belonging to the firm; and

(h) enter into a partnership on behalf of the firm.

Extent of Partners' Liability

It is, however, open to the partners by means of an express contract to extend or limit the implied authority, but third parties will be bound by such limitations only when they have notice of such curtailment.

All partners are liable jointly and severally for all acts or omissions binding on the firm including liabilities arising from contracts as well as torts (Section 25). This is known as the liability of partners for the acts of the firm. But in order that an act done may be an act of the firm and, therefore, binding on the firm, it is necessary that the partner doing the act on behalf of the firm must have done that act in the name of and on behalf of the firm and not in his personal capacity. And the act must have been done in the ordinary course of the business of the firm. [Sections 19(1) and 22]

Liability of the Firm for Torts

Every partner is liable for the negligence and fraud of the other partners in the course of the management of business. A partner charges the firm if he acts as an agent for it. The firm is similarly liable where a partner commits a tort with the authority of his co-partners. (Section 26)

If a partner acting within the scope of his apparent authority receives the property of a third person and misapplies it, or if the firm in the course of its business receives the property of a third person and, while it is in the firm's custody, a partner misapplies it, in each case the firm is liable to make good the loss. (Section 27)

Liability of an Incoming Partner

As a general rule, an incoming partner is not liable for the debts incurred before he joined the firm as a partner [Section 31(2)]. The incoming partner may, however, assume liability for past debts by novation, i.e., by a tripartite agreement between (i) the creditor of the firm, (ii) the partners existing at the time the debt was incurred, and (iii) the incoming partner.

Liability of an Outgoing or Retiring Partner

An outgoing partner remains liable for the partnership debts contracted while he was a partner. He may, however, be discharged by novation, i.e., by an agreement between himself, the new firm and the creditors. He may also continue to be liable after retirement if he allows himself to be held out as a partner, e.g. by allowing his name to remain the firm name. To protect himself from his liability, he should give express notice of his retirement to the persons who were dealing with the firm before his retirement or give public notice in the manner as laid down in Section 72 of the Act, that is to say, by publishing it in the Official Gazette and in at least one vernacular newspaper where the firm carries on the business. [Section 32(3)]

Death or Insolvency

The estate of a partner who dies, or who becomes insolvent, is not liable for partnership debts contracted after the date of the death or insolvency. It will, however, be liable for debts incurred before death or insolvency. (Sections 34 and 35)

Dissolution

According to Section 39 “The dissolution of partnership between all the partners of a firm” is called the “Dissolution of the Firm”. A dissolution does not necessarily follow because the partnership has ceased to do business, for the partnership may continue for the purpose of realising the assets.

The Partnership Act makes a distinction between the “dissolution of partnership” and “dissolution of firm”. Where there is dissolution of partnership between all the partners of a firm, it is a dissolution of the firm (Section 39). Where there is an extinction of relationship between some of the partners only, it is a dissolution of partnership. So the dissolution of a partnership may or may not include the dissolution of the firm, but the dissolution of the firm necessarily means the dissolution of the partnership as well.

Dissolution of Partnership

The dissolution of partnership takes place (even when there is no dissolution of the firm) in the following circumstances:

(a) By the expiry of the fixed term for which the partnership was formed. [Section 42(a)]

(b) By the completion of the adventure. [Section 42(b)]

(c) By the death of a partner. [Section 42(c)]

(d) By the insolvency of a partner. [Section 42(d)]

(e) By the retirement of a partner. [Section 42(e)]

In all the above cases, the remaining partners may continue the firm in pursuance of an agreement to that effect. If they do not continue then the dissolution of the firm takes place automatically.

Dissolution of the Firm

In the following cases there is necessarily a breaking up or extinction of the relationship between all the partners of the firm, and closing up of the business:

(a) *By mutual agreement:* A firm may be dissolved where all the partners agree that it shall be dissolved. (Section 40)

(b) *By the insolvency of all the partners but one:* If all the partners except one become insolvent, the firm must come to an end, as a partnership firm with one partner cannot continue. [Section 41(a)]

(c) *By business becoming illegal:* If the business of the firm becomes illegal because of some subsequent events, such as change of law, it is automatically or compulsorily dissolved by the operation of law. [Section 41(b)]

(d) *By notice of dissolution:* Where the partnership is at will, the firm may be

dissolved at any time, by any partner giving notice in writing of his intention to dissolve the firm, to all the other partners. The dissolution will take place from the date mentioned in the notice or, if no such date is mentioned, as from the date of the communication of the notice. (Section 43)

Dissolution of the Firm through Court

Unlike a partnership at will, the partnership for a fixed period cannot be dissolved by a notice. It could only be dissolved by Court in a suit by a partner. Though remedy of dissolution by a suit is available in case of all kinds of partnership, it is of practical importance in case of partnership for a fixed period.

As per Section 44, the Court may order dissolution of the firm in the following circumstances:

(a) *When a partner becomes of unsound mind:* As the insanity of a partner does not automatically dissolve the firm, either the lunatic through his guardian or other partners may file a suit for the dissolution of the firm, in either case the Court may order dissolution which will take effect from the date of the order.

(b) *Permanent incapacity of a partner:* Where a partner has become permanently incapable of performing his duties as a partner, e.g., he becomes blind, paralytic, etc., the Court may, at the instance of any of the other partners, order the dissolution of the firm.

(c) *Misconduct of a partner affecting the business:* Where a partner is guilty of misconduct, which is likely to affect prejudicially the business of the firm, the Court may dissolve the firm at the instance of any of the other partners. Gambling by a partner or conviction of a partner for travelling without ticket would be sufficient ground for dissolution.

(d) *Persistent disregard of partnership agreement by a partner:* Where a partner frequently commits breaches of the partnership agreement and the other partners find it impossible to carry on the business, the Court may order dissolution at the instance of the other partners.

(e) *Transfer of interest or share by a partner:* A partner is not entitled to assign away his interest so as to introduce a new partner into the firm. Where a partner has transferred the whole of his interest to a third person or where his interest has been attached under a decree or sold under a process of law, the other partners may sue for dissolution.

(f) *Business working at a loss:* The Court may dissolve a partnership firm where it is satisfied that the business of the firm cannot be carried on except at a loss.

(g) *Where just and equitable:* As the grounds mentioned are not exhaustive, the Court may dissolve a firm on any other ground if it is satisfied that it would be just and equitable to dissolve the firm. The Court may order dissolution where the sub-stratum of the partnership firm has gone or where there is a complete

deadlock and destruction of confidence between the partners [re. *Yenidjee Tobacco Co. Ltd.* (1916) 2 Ch. 426].

Effect of Dissolution

Continuing authority of partners

The authority of partners to bind the firm continues so long as is necessary to wind up the business, provided that the firm is in no case bound by the acts of a partner who has been adjudged an insolvent except on the principle of holding out. (Section 47)

Also each partner has an equitable lien over the firm's assets entitling him to have them applied in payment of the firm's debts, and in payment of whatever is due to partner. This lien can be enforced by injunction forbiding unfair distribution. (Section 46)

Continuing liability of partners

The partners continue to be liable to outsiders for any act done by any of them which would have been an act of the firm if done before the dissolution, unless a public notice is given of the dissolution.

After dissolution, the rights and obligations of partners continue in all things necessary for the winding up of the business. The partners may complete unfinished transactions. But this authority is only for the winding up of the affairs of the firm and not for new transactions.

Right to Return of Premium

To buy entry into an existing firm, a new partner sometimes has to pay a premium to the existing partners in addition to any investment of capital. On dissolution, he is entitled to demand the return of a proportion of the premium if the partnership was for a fixed term and was dissolved before the expiry of that term, unless dissolution was caused by (i) agreement, or (ii) misconduct of the party seeking return of the premium, or (iii) death of a partner. (Section 51)

Settlement of Accounts on Dissolution

Section 48 of the Act provides that in settling accounts between the partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed:

(a) Losses, including deficiencies of capital shall be paid first out of undistributed profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits

(b) The assets of the firm, including the sums, contributed by the partners to make up losses or deficiencies of capital shall be applied in the following manner and order:

(i) in paying outside creditors;

(ii) in repaying advances made by partners (distinct from investment of capital);

(iii) in repaying capital to partners; and

(iv) the ultimate residue, if any, shall be divided among the partners in the proportions in which profits are divisible.

Where the assets are not sufficient, the partners have to bear the loss in equal shares. After they have contributed their share of the deficiency they will be paid rateably the amount due to them by way of their capital (The Rule followed in the case of *Garner* v. *Murray,* 1904 73 L.J. Ch. 66).

Remaining Deficiencies of Capital

Where after paying outside creditors and repaying advances made by partners, as in (i) and (iii) above, there remains insufficient capital to repay all the partners, in full, deficiencies are shared in the same way as profits, in other words, the partners are paid rateably each according to his share in the capital.

But under the Rule in *Garner* v. *Murray,* if such deficiency is attributable to the insolvency of one of the partners, that deficiency must be borne by the other partners in the proportion of their last agreed shares in the capital, and not in the proportion in which they share profits and losses.

Goodwill

This is a partnership asset and means the benefit arising from a firm's business connections or reputation. "It is the advantage which is acquired by a business, beyond the mere value of the capital, stock fund and properly employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers". Though an intangible asset, it has value; and unless otherwise agreed in the partnership articles, upon dissolution it must be sold and the proceeds of sale distributed as capital. Where dissolution is caused by death, the estate of the deceased partner is entitled to share in the proceeds of the sale.

If the goodwill is sold and there is no agreement as to its disposal, any partner can carry on the business, provided that by doing so he does not expose former partners to liability. But if by agreement the goodwill is assigned to any person, he can restrain partners as explained in the next para.

Sale of Goodwill

Where goodwill is sold, either to a partner or to an outsider, the value is divisible among the partners in the same manner as they share profits and losses, unless otherwise agreed.

The rights of the buyer and seller of the goodwill are as follows:

(a) *Buyer's rights:* On the sale of goodwill the buyer may, unless the terms in the contract of sale provide otherwise:

(i) represent himself in continuing the business,

(ii) maintain his exclusive rights to the use of the firm name, and

(iii) solicit former customers of the business and restrain the seller of the goodwill from doing so.

(b) Seller's rights: The vendors may enter into competition with the purchaser unless he is prevented by a valid restraint clause in the contract of sale.

Registration of the Firm

Section 56-71 deal with the registration of a firm and consequences of non-registration.

Registration

The registration of a firm may be effected at any time by sending by post or delivering to the Registrar of the area in which any place of business of the firm is situated or proposed to be situated, a statement in the prescribed form and accompanied by the prescribed fee, stating:

(a) the name of the firm;

(b) the place or principal place of business of the firm;

(c) the names of any other places where the firm carries on business;

(d) the date when each partner joined the firm;

(e) the names in full and permanent addresses of the partners; and

(f) the duration of the firm.

The statement shall be signed and verified by all the partners or by their agents specially authorised in this behalf. (Section 58)

The Partnership Act, 1932, does not make registration of a firm compulsory but it introduces certain disabilities, which makes registration necessary at one time or other. An unregistered firm is not an illegal association.

Effects of Non-registration

The following are the effects of non-registration of a firm:

1. Sub-section (1) of Section 69 places a bar on the right of the partners of a firm to sue each other or the firm for enforcing any right arising from a contract or conferred by the Partnership Act, if the firm is not registered and the person suing is or has not been shown in the Register of Firms as a partner in the firm.
2. Sub-section (2) of Section 69 places a bar on the institution of a suit by or on behalf of a firm against a third-party if the firm is not registered and the persons suing are or have not been shown in the Register of Firms as partners in the firm.
3. There is no bar on the right of third-parties to sue the firm or any partner.

   However, the Act allows the following suits:

   (a) A suit for the dissolution of a firm.

(b) A suit for rendering of accounts of a dissolved firm.

(c) A suit for realisation of the property of a dissolved firm.

(d) A suit or claim of set-off, the value of which does not exceed one hundred rupees,

(e) A proceeding in execution or other proceeding incidental to or arising from a suit or claim for not exceeding one hundred rupees in value.

(f) A suit by a firm which has no place of business in the territories to which the Indian Partnership Act extends.

(g) A suit for the realisation of the property of an insolvent partner.

(h) A suit by a firm whose places of business are situated in areas which are exempted from the application of Chapter VII of the Indian Partnership Act, 1932.

Section 69 bars the very institution of a suit by an unregistered firm or by its partners. Registration is a condition precedent to the right to institute the suit and, therefore, the condition precedent must first be fulfilled before the institution of the suit. If, therefore, on the date of the institution of a suit, the firm is not registered, the subsequent registration cannot validate the suit. The only option left to the Court is to dismiss the suit (*Prithvi Singh v. Hasan Ali,* (1950) Bom. L.R. 862). By virtue of this provision a partner of an unregistered firm cannot institute a suit to compel the other partner or partners to join in the registration of firm. The only remedy of such a partner is to institute a suit for dissolution (*Keshav Lal v. Chuni Lal,* AIR 1941 Rangoon 196). A suit by the firm is really a suit by all the partners who were its partners at the time of the accrual of the cause of action and, therefore, all must join in the institution of the suit.

However, an unregistered firm can bring a suit to enforce a right arising otherwise than out of contract e.g., for an injunction against a person for wrongful infringement of trade mark etc.

Specific Performance of Partnership Agreement

It is not allowed. The working of a partnership depends upon the personal inclination of the partners, there can be no specific performance of a partnership agreement (*Scott* v. *Raymont*, 1868, 7 Fq. 112).

Suit for Libel or Slander

A firm is merely a collection of partners and cannot bring a suit for libel or slander. Libel or slander against a firm imply a libel or slander of its partners. Such partners themselves or any one may file the suit for libel or slander (*P.K. Oswal Hosiery Mills* v. *Tilak Chand,* AIR 1969, Punj. 150).

SELF-TEST QUESTIONS

1. Describe the essentials of partnership. What is the true test of partnership?
2. Distinguish between (i) co-ownership and partnership, (ii) Hindu Joint Family firm and partnership, (iii) company and partnership, (iv) dissolution of partnership and dissolution of a firm.
3. What is the position of a minor in a partnership?

4. Discuss the liability of partners *inter se*.
5. Whether registration of a firm is compulsory? Discuss the effects of non-registration.
6. Briefly discuss the provisions relating to the dissolution of partnership or firm and what are its effects?
7. Write short notes on:
   (i) Specific performance of partnership agreement.
   (ii) Whether a firm can bring a suit for libel or slander.
8. "Sharing of profits is a *prima facie* evidence of partnership but not a conclusive evidence".—Discuss.

Suggested Readings:

(1) A manual of Mercantile Law—*M.C. Shukla*
(2) The Indian Partnership Act, 1932—*Bare Act*
(3) Elements of Mercantile Law—*N.D. Kapoor*
(4) Law of Partnership—*Avtar Singh*

STUDY VI

ELEMENTS OF COMPANY LAW - I

A. COMPANY — MEANING AND CHARACTERISTICS

Company — It's Meaning

The word "company" is derived from the Latin (Com = with or together; panis = bread), and originally referred to an association of persons who took their meals together. It may be assumed, since human nature does not change that in the leisurely past no less than in the speedy present, merchants took advantage of festive gatherings, to discuss business matters. Now-a-days, the business matters have become most complicated and cannot be discussed at length on festive gatherings. Therefore, the word "company" has assumed great importance as it denotes a joint stock enterprise in which the capital is contributed by a large number of people. Thus, in popular parlance, company denotes an association of like minded persons formed for the purpose of carrying on same business or undertaking. Though an association may be brought into existence for multifarious purposes, in Company Law it figures predominantly as a business association with a large and fluctuating membership formed for making a gain as profit. There may also be non-profit trading concerns like a club or a society. In *Smith* v. *Anderson,* (1880) 15 Ch.D.247, it was observed that "a company, in broad sense, may mean an association of individuals formed for some purpose".

A company may be an incorporated company or a "corporation" or an unincorporated company. An incorporated company is a separate person distinct from the individuals constituting it whereas an unincorporated company, such as a partnership, is mere collection or aggregation of individuals. Therefore, unlike a partnership firm, a company is a corporate body and a legal person having status and personality distinct and separate from that of the members constituting it.

It is called a body corporate because the persons composing it are made into one body by incorporating it according to the law, and clothing it with legal personality, and, so turn it into a corporation (The word "corporation" is derived from the Latin term "corpus" which means "body"). Accordingly, "corporation" is a legal person created by the process other than natural birth. It is, for this reason, sometimes called artificial person. This corporate being is capable of enjoying many of the rights and incurring many of the liabilities of a natural person - a human being.

The incorporated company owes its existence to a special Act of Parliament or to a company legislation which in India, is the Companies Act, 1956. The public corporations like Life Insurance Corporation of India and Damodar Valley Corporation have been brought into existence through special Acts of Parliament whereas companies like Tata Iron and Steel Co. Ltd., Hindustan Lever Ltd., Delhi Cloth and General Mills Ltd., and State Trading Corporation of India Ltd. have been formed under the Companies Act, 1956. The trading partnership which is governed by Partnership Act is the most apt example of an unincorporated association.

In the legal sense, a company is an association of both natural and artificial persons incorporated under the existing law of a country. As per the Companies Act, 1956 a "company means a company formed and registered under the Companies Act, 1956 or under the previous laws relating to companies" [Section 3(1)(ii)]. In

common law, a company is a “legal person” or “legal entity” separate from, and capable of surviving beyond the lives of, its members. However, an association formed not for profit acquires a corporate life and falls within the meaning of a company by reason of a licence under Section 25(1) of the Act.

Company — Its Characteristics

The main characteristics of a company are as follow:

Corporate Personality

By incorporation under the Act, the company is vested with a corporate personality quite distinct from individuals who are its members. Being a separate legal entity it bears its own name and acts under a corporate name. It has a seal of its own. Its assets are separate and distinct from those of its members. It is also a different ‘person’ from the members who compose it. As such it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual. Its members are its owners but they can be its creditors simultaneously as it has a separate legal entity. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The shareholders are not the agents of the company and so they cannot bind it by their acts. The company does not hold its property as an agent or trustee for its members and they cannot sue to enforce its rights, nor can they be sued in respect of its liabilities. The case of *Salomon* v. *Salomon and Co. Ltd.,* (1897) A.C. 22, has clearly established the principle that once a company has been validly constituted under the Companies Act, 1956 it becomes a legal person distinct from its members and for this purpose it is immaterial whether any member has a large or small proportion of the shares, and whether he holds those shares beneficially or as a mere trustee. The facts of this case are as follows:

Salomon had, for some years, carried on a prosperous business as leather merchant and boot manufacturer. He formed a limited company consisting of himself, his wife, his daughter and his four sons as the shareholders, all of whom subscribed for 1 share each so that the actual cash paid as capital was £ 7. Salomon sold his business (which was perfectly solvent at that time), to the Company for the sum of £ 38,782. The company’s nominal capital was £ 40,000 in £ 1 shares. In part payment of the purchase money for the business sold to the company, debentures of the amount of £ 10,000 secured by a floating charge on the company’s assets were issued to Salomon, who also applied for and received an allotment of 20,000 £ 1 fully paid shares. The remaining amount of £ 8,782 was paid to Salomon in cash. Salomon was the managing director and two of his sons were other directors.

The company soon ran into difficulties and the debentureholders appointed a receiver and the company went into liquidation. The total assets of the company amounted to £6050, its liabilities were £10,000 secured by debentures, £8,000 owning to unsecured trade creditors, who claimed the whole of the company’s assets, viz., £6,050, on the ground that, as the company was a mere ‘alias’ or agent for Salomon, they were entitled to payment of their debts in priority to debentures. They further pleaded that Salomon, as principal beneficiary, was ultimately responsible for the debts incurred by his agent or trustee on his behalf. The trial judge and the Appellate Court agreed with these contentions and decreed against Salomon. The

House of Lords disagreeing with the lower Courts, repudiated these contentions and accepted the appeal and reversed the order of the Appellate Court. The House of Lords held that on registration, the company comes into existence and attains maturity on its birth. There is no period of minority, no interval of incapacity. It has its own existence or personality separate and distinct from its members and, as a result, a shareholder cannot be held liable for its acts even though he holds virtually the entire share capital. Thus, the case also established the legality of what is known as "one-man company". The case also recognised that subscribers do not have to be independent or strangers to one another. The case also recognised the principle of limited liability. It also established that a person can be at the same time a member, a creditor and an employee of the company, as well as its director.

Their Lordships observed:

"When the memorandum is duly signed and registered, though there be only seven shares taken, the subscribers are a body corporate capable forthwith of exercising all the functions of an incorporated company. It is difficult to understand how a body corporate thus created by statute can lose its individuality by issuing the bulk of its capital to one person. The company is at law a different person altogether from the subscribers of the memorandum; and though it may be that after incorporation the business is precisely the same as before, the same persons are managers, and the same hands receive the profits, the company is not in law their agent or trustee."

Limited Liability

The company being a separate entity, leading its own business life, the members are not liable for its debts.

The liability of the members of a company is limited to the extent of the nominal value of the shares held by them. In no event can a shareholder be asked to pay anything more than the unpaid value of his shares. In the case of a company limited by guarantee, the members are liable only to the extent of the amount guaranteed by them and not beyond, and only when the company goes into liquidation.

Perpetual Succession

Members may come and members may go but the company goes on for ever. Variation in members or their identity does not affect the legal existence and identity of a company. It is a creation of law and can be dissolved only under the law.

Transferability of Shares

The capital of a company is divided into parts, called shares. The shares are said to be movable property and, subject to certain conditions, freely transferable, so that no shareholder is permanently or necessarily wedded to a company. The shares of joint stock companies are freely transferable. In the case of a private company, the Companies Act requires it to put certain restrictions on the transferability of shares. Every member owing fully paid-up shares is at liberty to dispose them off according to his choice but subject to the articles of the company. Any absolute restriction on the right to transfer shares is void.

Separate Property

As a corporate person, the company is entitled to own and hold property in its own name. No member can claim ownership of any item of the company's assets.

Common Seal

On incorporation, a company acquires legal entity with perpetual succession and a common seal. Since the company has no physical existence, it must act through its agents and all such contracts entered into by its agents must be under the seal of the company. The common seal of the company is of very great importance. It acts as the official signature of a company. The name of the company must be engraved on its common seal. A rubber stamp does not serve the purpose. A document not bearing common seal of the company is not authentic and has no legal force behind it.

Capacity to Sue and Be Sued

A company being a body corporate, can sue and be sued in its own name. All legal proceedings against the company are to be instituted in its own name. Similarly, the company may bring an action against anyone in its own name. In case of unincorporated association an action may have to be brought in the name of the members either individually or collectively.

Company as Distinguished from other Associations of Persons

Though there are a number of similarities between a limited company and other forms of associations, there are many dissimilarities. In both the cases individuals are the subjects, and trading is generally the object. In the following paragraphs a limited company is distinguished from a partnership firm, a Hindu Joint Family business, a club and a registered society.

Though there are a number of similarities between a limited company and other forms of associations, there are a great number of dissimilarities as well. In both the cases individuals are the subjects, and trading is generally the object. In the following paragraphs, a limited company is distinguished from a partnership firm, a Hindu Joint Family business and a registered society.

Distinction between Company and Partnership

The principal points of distinction between a company and a partnership firm, are as follows:

1. A company is a distinct legal person. A partnership firm is not distinct from the several persons who compose it.
2. In a partnership, the property of the firm is the property of the individuals comprising it. In a company, it belongs to the company and not to the individuals comprising it.
3. Creditors of a partnership firm are creditors of individual partners and a decree against the firm can be executed against the partners jointly and severally. The creditors of a company can proceed only against the company and not against its members.
4. Partners are the agents of the firm, but members of a company are not its agents. A partner can dispose of the property and incur liabilities as long as he acts in the course of the firm's business. A member of a company has no

such power.

5. A partner cannot contract with his firm, whereas a member of a company can.
6. A partner cannot transfer his share and make the transferee a member of the firm without the consent of the other partners, whereas a company's share can ordinarily be transferred.
7. Restrictions on a partner's authority contained in the partnership contract do not bind outsiders; whereas such restrictions incorporated in the Articles are effective, because the public are bound to acquaint themselves with them.
8. A partner's liability is always unlimited whereas that of shareholder may be limited either by shares or a guarantee.
9. A company has perpetual succession, i.e. the death or insolvency of a shareholder or all of them does not affect the life of the company, whereas the death or insolvency of a partner dissolves the firm, unless otherwise provided.
10. A company may have any number of members except in the case of a private company which cannot have more than fifty members (excluding past and present employee members). In a public company there must not be less than seven persons and in a private company not less than two. On the other hand, a partnership firm cannot have more than 20 members in any business and 10 in the case of banking business.
11. A company is legally required to have its accounts audited annually by a chartered accountant, whereas the accounts of a firm are audited at the discretion of the partners.
12. A company, being a creation of law, can only be dissolved as laid down by law. A partnership firm, on the other hand, is the result of an agreement and can be dissolved at any time by agreement.

Distinction between Company and Hindu Joint Family Business

1. A company consists of heterogeneous members, whereas a Hindu Undivided Family Business consists of homogenous members since it consists of members of the joint family itself.
2. In a Hindu Joint Family business the Karta (manager) has the sole authority to contract debts for the purpose of the business, other coparceners cannot do so. There is no such system in a company.
3. A person becomes a member of Joint Hindu Family business by virtue of birth. There is no provision to that effect in the company.
4. No registration is compulsory for carrying on business for gain by a Hindu Joint Family even if the number of members exceeds twenty [*Shyamlal Roy* v. *Madhusudan Roy*, AIR 1959 Cal. 380 (385)]. Registration of a company is compulsory.

Distinction between a Company and a Club

1. A company is a trading association. A club, on the other hand, is a non-trading association.
2. Registration of a company is compulsory. Registration of a club is not

compulsory.

Distinction between a Company and a Corporation (i.e. Company *vis-à-vis* Body Corporate)

Generally speaking, an association of persons incorporated according to the relevant law and clothed with legal personality separate from the persons constituting it is known as a corporation. The word 'corporation' or words 'body corporate' is/are both used in the Companies Act, 1956. Definition of the same which is reproduced below is contained in Clause (7) of Section 2 of the Act:

"Body corporate" or "corporation" includes a company incorporated outside India but does not include—

(a) a corporation sole;

(b) a co-operative society registered under any law relating to co-operative societies; and

(c) any other body corporate not being a company which the Central Government may, by notification in the Official Gazette, specify in this behalf."

The expression "corporation" or "body corporate" is wider than the word 'company'.

A corporation sole is a single individual constituted as a corporation in respect of some office held by him or function performed by him. The Crown or a Bishop under the English law are examples of this type of corporation. It may be noted that though a corporation sole is excluded from the definition for the purposes of the Companies Act, it continues to be a legal person capable of holding property and becoming a member of a company.

A society registered under the Societies Registration Act has been held by the Supreme Court in *Board of Trustees* v. *State of Delhi,* A.I.R. 1962 S.C. 458, not to come within the term 'body corporate' under the Companies Act, though it is a legal person capable of holding property and becoming a member of a company.

Advantages of Incorporation

As compared to other types of business associations, an incorporated company has the following advantages:

A. *Corporate Personality:* Unlike a partnership firm, which has no existence apart from its members, a company is a distinct legal or juristic person independent of its members. Under the law, an incorporated company is a distinct entity, even the one-man company as discussed above in Salomon & Co. Ltd., case is different from its shareholders.

Section 34(2) of the Companies Act, 1956 provides that from the date of incorporation, the subscribers to the memorandum and other members shall be a body corporate by the name contained in the Memorandum, capable of exercising all the functions of an incorporated company and having perpetual succession and a common seal.

B. *Limited Liability:* The Companies Act provides that in the event of the

company being wound-up, the members shall have liability to contribute to the assets of the company in accordance with the Act [Section 34(2)]. In the case of companies limited by shares, no member is bound to contribute anything more than the nominal value of the shares held by him which remains unpaid. The privilege of limiting the liability is one of the principal advantages of doing business under the corporate form of organisation.

C. *Perpetual Succession:* As stated in Section 34(2) of the Companies Act, an incorporated company has perpetual succession. Notwithstanding any change in its members, the company will be the same entity with the same privileges and immunities, estate and possessions. The death or insolvency of individual members does not in any way, affect the corporate entity, its existence or continuity. The company shall continue to exist indefinitely till it is wound-up in accordance with the provisions of the Companies Act. "Members may come and members may go but the company can go on forever".

D. *Transferable Shares:* Section 82 of the Companies Act provides "The shares or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company". This encourages investment of funds in the shares, so that the members may encash them at any time. Thus, it provides liquidity to the investors as shares could be sold in the open market and in stock exchange. It also provides stability to the company.

E. *Separate Property:* A company as a legal entity is capable of owning its funds and other assets. "The property of the company is not the property of the shareholders, it is property of the company" [*Gramophone & Typewriter Co.* v. *Stanley,* (1906) 2 K.B. 856 at p. 869]. "The company is the real person in which all the property is vested, and by which it is controlled, managed and disposed of". In the eyes of law, even a member holding majority of shares or a managing director of a company is held liable for criminal mis-appropriation of the funds or property of the company, if he unauthorisedly takes it away and uses it for his personal purposes.

F. *Capacity to Sue:* As a juristic legal person, a company can sue in its name and be sued by others. The managing director and other directors are not liable to be sued for dues against a company.

G. *Flexibility and Autonomy:* The company has an autonomy and independence to form its own policies and implement them, subject to the general principles of law, equity and good conscience and in accordance with the provisions contained in the Companies Act, Memorandum and Articles of Association. The company form of management of business disassociates the "ownership" from the "control" of business, and helps promote professional management and efficiency. The directors and managers can carry on the business activities with freedom, authority and accountability in accordance with the Company Law. Precisely this is the reason why the Government has generally adopted the company form of management for its various undertakings in preference to management through the departmental undertakings.

Disadvantages of Incorporation

There are, however, certain disadvantages and inconveniences in Incorporation. Some of these disadvantages are:

1. *Formalities and expenses:* Incorporation of a company is coupled with complex, cumbersome and detailed legal formalities and procedures, involving considerable amount of time and money. Such elaborate procedures have been laid down to deter persons who are not serious about doing business, as a company enjoys various facilities from the community. Even after the company is incorporated, its affairs and working must be conducted strictly in accordance with legal provisions. Thus various returns and documents are required to be filed with the Registrar of Companies, some periodically and some on the happening of an event. Certain books and registers are compulsorily required to be maintained by a company. Approval and sanction of the Company Law Board, the Government, the Court, the Registrar of Companies or other appropriate authority, as the case may be, is necessarily required to be obtained for certain corporate activities. Certain corporate activities such as corporate meetings, accounts, audit, borrowings, lending, investment, issue of capital, dividends etc. are necessarily required to be conducted and carried out strictly in accordance with the provisions of the Act and within the prescribed time. Any breach of the legal provisions is followed by severe penal consequences. Other forms of business organisations are comparatively free from these legal complexities and procedural formalities.
2. *Corporate disclosures:* Notwithstanding the elaborate legal framework designed to ensure maximum disclosure of corporate information, the members of a company are having comparatively restricted accessibility to its internal management and day-to-day administration of corporate working.
3. *Separation of control from ownership:* Members of a company are not having as effective and intimate control over its working as one can have in other forms of business organisation, say, a partnership firm. This is particularly so in big companies in which the number of members is too large to exercise any effective control over its day-to-day affairs. No member of a company can act in his individual capacity for and on behalf of the company. The members of a company are neither the owners nor the agents of the company. Thus, the position of ownership of members is more passive in nature. The members may not have an active and complete control over the company's working as the partners may have over the firm's affairs.
4. *Greater social responsibility:* Having regard to the enormous powers wielded by the companies and the impact they have on the society, the companies are called upon to show greater social responsibility in their working and, for that purpose, are subject to greater control and regulation than that by which other forms of business organisation are governed and regulated.
5. *Greater tax burden in certain cases:* In certain circumstances, the tax burden on a company is more than that on other forms of business organisation. A company is liable to tax without any minimum taxable limit as is prescribed in the cases of registered partnership firms and others. Also it has to pay income-tax on the whole of its income at a flat rate whereas others are taxed

on graduated scale or slab system. These tax implications may have crucial bearing on a decision regarding the selection of any form of business organisation and the time when the existing form of business organisation should be changed to a new one. Thus, tax implications may direct the adoption of the partnership form of business organisation as expedient at the initial stage to be converted into a company later on, when the tax implications may be more favourable because of the size of the organisation and its scale of operations.

6. *Detailed winding-up procedure:* The Act provides elaborate and detailed procedure for winding-up of companies which is more expensive and time consuming than that which is applicable to other forms of business organisation.

There are, however, some exceptions to the principles of Corporate Personality and the Limited Liability of members. These are discussed below:

Lifting or Piercing the Corporate Veil

Law has clothed a corporation with a distinct personality, yet in reality it is an association of persons who are in fact, in a way, the beneficial owners of the property of the body corporate. A company, being an artificial person, cannot act on its own, it can act only through natural persons.

Indeed, the theory of corporate entity is still the basic principle on which the whole law of corporations is based. But as the separate personality of the company is a statutory privilege, it must be used for legitimate business purposes only. Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will breakthrough the corporate shell and apply the principle of what is known as “lifting of or piercing through the corporate veil”. The Court will look behind the corporate entity and take action as though no entity separate from the members existed and make the members or the controlling persons liable for debts and obligations of the company.

The corporate veil is lifted when in defence proceedings, such as for the evasion of tax, an entity relies on its corporate personality as a shield to cover its wrong doings. [*BSN (UK) Ltd.* v. *Janardan Mohandas Rajan Pillai* [1996] 86 Comp. Cas. 371 (Bom).]

In the following cases the Courts have lifted the corporate veil:

1. Where the corporate veil has been used for commission of fraud or improper conduct, Courts have lifted the veil and looked at the realities of the situation. In *Gilford Motor Co.* v. *Horne,* (1933) 1 Ch. 935, a former employee of a company made a covenant not to solicit its customers. He formed a company which undertook solicitation. The company was restrained by the Court.

2. Where the corporation is really an agency or trust for some one else and the corporate facade is used to cover up that agency or trust. In re *R.G. Films Ltd.,* (1953) 1 All E.R. 615, an American company produced a film in India technically in the name of a British Company, 90% of whose capital was held by the President of the American Company which financed the production of the film. Board of Trade refused to register the film as a British film on the

ground that English company acted merely as the nominee of the American corporation.

3. Where the doctrine conflicts with public policy, Courts have lifted the corporate veil for protecting the public policy. In *Connors Bros.* v. *Connors* (1940) 4 All E.R. 179, the principle was applied against the managing director who made use of his position contrary to public policy. In this case, the House of Lords determined the character of the company as "enemy" company, since the persons who were *de facto* in control of its affairs, were residents of Germany, which was at war with England at that time. The alien company was not allowed to proceed with the action, as that would have meant giving money to the enemy, which was considered as monstrous and against "public policy".
4. For determining the true character or status of the company. In *Daimler Co. Ltd.* v. *Continental Tyre and Rubber Co.,* (1916) 2 A.C. 307, the Court looked behind the facade of the company and its place of registration in order to determine the true character of the company, i.e., whether it was an "enemy" company.
5. Where the veil has been used for evasion of taxes and duties, the Court upheld the piercing of the veil to look at the real transaction. (*Commissioner of Income Tax* v. *Meenakshi Mills Ltd.,* A.I.R. (1967) S.C. 819).
6. Where it was found that the sole purpose for which the company was formed was to evade taxes the Court will ignore the concept of separate entity, and make the individuals liable to pay the taxes which they would have paid but for the formation of the company. In the case of *Sir Dinshaw Manakjee Petit, AIR 1927 Bombay 371,* the assessee was a wealthy man enjoying large dividend and interest income. He formed four private companies and agreed with each to hold a block of investment as an agent for it. Income received was credited in the accounts of the company but the company handed back the amount to him as a pretended loan. This way he divided his income in four parts in a bid to reduce his tax liability. The Court disregarded the corporate entity on the grounds that the company was formed by the assessee purely and simply as a means of avoiding tax and the company was nothing more than the assessee himself.
7. Where the purpose of company formation was to avoid welfare legislation. Where it was found that the sole purpose for the formation of the new company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction (*The Workmen Employed in Associated Rubber Industries Limited, Bhavnagar* v. *The Associated Rubber Industries Ltd., Bhavnagar and another,* A.I.R. 1986 SC 1).

B. KINDS OF COMPANIES

The Companies Act, 1956 provides for a variety of companies of which can be promoted and registered under the Act. The three basic types of companies which may be registered under the Act are:

(a) Private Companies;

(b) Public Companies; and

(c) Producer Companies.

These companies may be:

(i) limited by shares;
(ii) limited by guarantee; or
(iii) unlimited companies.

Companies may also be classified as:

(a) Association not for profit having licence under Section 25 of the Companies Act, 1956;
(b) Government companies;
(c) Foreign companies;
(d) Holding companies; and
(e) Subsidiary companies.

A brief discussion of each type of company follows hereunder.

Private Company [Section 3(1)(iii)]

By virtue of Section 3(1)(iii), a private company means a company which has a minimum paid-up capital of one lakh rupees or such higher paid up capital as may be prescribed, and by its articles:

(a) restricts the right to transfer its shares, if any;
(b) limits the number of members to fifty not including: (i) persons who are in the employment of the company, and (ii) persons who, having been formerly in the employment and have continued to be members after the employment ceased;
(c) prohibits any invitation to the public to subscribe for any shares in, or debentures of the company; and
(d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

Provided that where two or more persons hold one or more shares in a company jointly, they shall be counted as a single member.

There should be at least two persons to form a private company. A private company can therefore be registered with a minimum of 2 members and cannot have more than 50 members (excluding employee and ex-employee members). It cannot invite the public to subscribe for its shares or debentures nor can its shares be freely transferred.

The words “Private Limited” must be added at the end of its name by a private limited company.

Privileges and Exemptions of Private Company

The Companies Act, 1956, confers certain privileges on private companies. Such companies are also exempted from complying with quite a few provisions of the Act. The basic rationale behind this is that since the private limited companies are restrained from inviting capital and deposits from the public, not much public interest is involved in their affairs as compared to public limited companies.

A private limited company which is or becomes subsidiary of a public limited company is not allowed to avail of all the privileges and concessions which otherwise are available to a private company which is not a subsidiary of a public company,

because such company, is a public company by virtue of Section 3(1)(iv)(c) of the Companies Act, 1956

Public Company [Section 3(1)(iv)]

Public Company means a company which

(a) is not a private company;

(b) has a minimum paid-up capital of five lakh rupees or such higher paid-up capital as may be prescribed;

(c) is a private company which is a subsidiary of a company which is not a private company.

A public company may be said to be an association consisting of seven or higher number of members, which is registered under the Companies Act, 1956, and which is not a private company within the meaning of the Act. The articles of a public company do not contain provisions restricting the number of its members or excluding generally the offer or transfer of shares or debentures to the public. In principal any member of the public who is willing to pay the price may acquire shares in, or debentures, of a public company. Also, shares and debentures of public companies are capable of being dealt on a stock exchange. Unlike a private company, there is no restriction with regard to the maximum number of members of a public company.

Distinction between a Public and a Private Company

1. *Minimum number:* The minimum number of persons required to form a public company is 7. It is 2 in case of a private company. [Section 12(1)]
2. *Maximum number:* There is no restriction on maximum number of members in a public company, whereas the maximum number cannot exceed 50 in a private company. [Section 3(1)(iii)(b)]
3. *Number of directors:* A public company must have at least 3 directors [Section 252(1)], whereas a private company must have at least 2 directors. [Section 252(2)]
4. *Restriction on appointment of directors:* In the case of a public company, the directors must file with the Registrar a consent to act as directors or sign an undertaking for their qualification shares [Section 266(1)]. The directors of a private company need not do so. [Section 266(5)(b)]
5. *Restriction on invitation to subscribe for shares:* A public company invites the general public to subscribe for the shares in, or the debentures of the company. A private company by its Articles prohibits any such invitation to the public. [Section 3(1)(iii)(c)]
6. *Transferability of shares:* In a public company, the shares are freely transferable (Section 82). In a private company the right to transfer shares is restricted by the Articles. [Section 3(1)(iii)(a)]
7. *Special privileges:* A private company enjoys some special privileges. A public company enjoys no such privileges.
8. *Managerial remuneration:* Total managerial remuneration in a public company cannot exceed 11 per cent of the net profits. No such restriction applies to a private company.

Private Company to become Public in certain cases (Section 43A)

The provisions of Section 43A of the Companies Act, 1956 have been made inoperative by the Companies (Amendment) Act, 2000 by insertion of sub-section (11) to Section 43A. A new sub-section (2A) has been inserted in Section 43A by the Companies (Amendment) Act, 2000 which provides that every public company which becomes a private company on or after the commencement of the Amendment Act, shall inform the Registrar about its status of private company and then the Registrar shall substitute the word "private company" for the word "public company" in the Register and shall also make necessary alterations in the Memorandum of Association and Certificate of Incorporation within four weeks from the date of application made by the company.

A Company Limited by Shares

A company limited by shares may be defined as a "registered company" whether public or private company having the liability of its members limited by its memorandum to the amount, if any, unpaid on the shares respectively held by them. In other words, a member of a company limited by shares is required to pay only the nominal amount of shares held by him and nothing more. If the shares are fully paid-up he has nothing more to pay.

A Company Limited by Guarantee

A company limited by guarantee is a registered company having the liability of its members limited by its memorandum to such an amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up.

A special feature of this type of company is that the liability of members to pay their guarantee amount arises only when the company goes into liquidation and not when it is a going concern.

Clubs, trade associations and societies for promoting different objects are at times incorporated as companies limited by Guarantee to take the advantages of incorporation without running the risk of heavy liabilities.

An Unlimited Company

An unlimited company is a company not having any limit on the liability of its members. Thus, the maximum liability of the members of such a company, in the event of its being wound up, might stretch up to the full extent of their properties to meet the obligations of the company by contributing to its assets. However, the members of an unlimited company are not liable directly to the creditors of the company, as in the case of partners of a firm. The liability of the members is only towards the company and in the event of its being wound up only the liquidator can ask the members to contribute to the assets of the company which will be used in discharging the debts of the company.

A company registered as an unlimited company may subsequently convert itself as a limited company, subject to the condition that any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the unlimited company before such conversion are not affected by such changed registration.

Association not for Profit

As per Section 13(1)(a) of the Companies Act, it is necessary that the name of every company registered with a limited liability should have the last word "Limited" if it is a public company and "Private Limited" if it is a private company. However, Section 25 permits the registration, under a licence granted by the Central Government, of associations not for profit with limited liability without being required to use the word "Limited' or the words 'Private Limited" after their names. This is of great value to companies not engaged in business like bodies pursuing charitable, educational or other purposes of great utility.

The Central Government may grant such a licence if:

(i) it is intended to form a company for promoting commerce, art, science, religion, charity or any other useful object; and

(ii) the company prohibits payment of any dividend to its members but intends to apply its profits or other income in promotion of its objects.

On registration, the Association enjoys all the privileges of a limited company and is subject to all its obligations, except, those in respect of which exemption by a special or general order is granted by the Central Government.

A Company, which has been granted licence under Section 25 cannot alter the provisions of its Memorandum with respect to its objects except with the previous approval of the Central Government in writing.

The Central Government has issued some notifications exempting certain companies under Section 25.

The Central Government may at any time revoke the licence whereupon the word "Limited' or "Private Limited' as the case may be, shall have to be used as part of its name and the company will lose the exemptions that might have been granted by the Central Government. However, the Central Government can do so only after providing such association an opportunity to be heard and the aggrieved association can challenge the order of the Central Government under Article 226 of the Constitution.

Government Companies (Section 617)

Section 617 defines a "Government company" as any company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government or partly by one or more State Governments. A subsidiary of a Government company is also treated as a Government company.

Government companies being public sector companies, their audit assumes special relevance. Hence, the Companies Act makes separate provision for their Audit. The auditor of a Government company is appointed or reappointed by the Comptroller and Auditor General of India. The Comptroller and Auditor General of India has the power to direct the manner in which the accounts are to be audited and to give instructions to the auditor in regard to any matter relating to the performance of his functions. He (C & AG. of India) may also conduct a supplementary test audit by persons authorised by him. The auditor of the company must submit a copy of his audit report to the C & AG, who may comment upon, or supplement, the audit report. Such comments or supplementary report must be placed before the annual general meeting

of the company at the same time and in the same manner as the auditor's report.

In addition, where the Central Government is holding shares in Government company, the Central Government is required to place before both the Houses of Parliament an annual report on the working and affairs of each Government Company within three months of its annual general meeting together with a copy of the audit report and any comments upon, or supplement to such report made by the Comptroller and Auditor General of India. Where a State Government is the member of a Government company, the annual report is likewise to be placed before the State Legislature.

Though Government companies are also governed by the provisions of the Companies Act as any other company; the Act empowers the Central Government to direct by notification in the Official Gazette that any of the provisions of the Act shall not apply to them or shall apply to them only with such exceptions, modifications and adaptations, as may be specified in the notification.

In exercise of this power, the Central Government has issued various notifications modifying the operations of different provisions of the Companies Act to Government Companies. A detailed discussion of notifications is not within the limited scope of this study.

Foreign Companies

A "foreign company" is a company which is incorporated in a country outside India under the law of that other country and has established a place of business in India. Sections 591 to 602 of the Act deal with such companies.

Foreign companies are of two classes namely:

(a) Companies incorporated outside India, which have established a place of business in India after April 1, 1956; and

(b) Companies incorporated outside India, which established a place of business in India before that date and continue to have an established place of business in India.

Section 592 of the Companies Act lays down that every foreign company which establishes a place of business in India must, within 30 days of the establishment of such place of business, file with the Registrar of Companies at New Delhi and also with the Registrar of Companies of the State in which such place of business is situated:

(a) a certified copy of the charter, statutes, or memorandum and articles of the company, or other instrument constituting or defining the constitution of the company, and if the instrument is not in the English language, a certified translation thereof;

(b) the full address of the registered or principal office of the company;

(c) a list of the directors and secretary of the company containing particulars of their names, nationality, addresses and business occupations;

(d) the names and addresses of one or more persons resident in India who are authorised to accept service of process and any notices or other documents required to be served on the company; and

(e) the full address of the principal place of business in India.

Every foreign company must conspicuously exhibit on the outside of its every

office or place of business in India its name ending with the words “Limited” or “Private Limited”, as the case may be, if it is a limited company; and the country of its incorporation in English as well as in the local language. The prospectus issued in India must also disclose the above information.

The same requirement as regards accounts and their filing and also the registration of the charges created in India are applicable to them as to Indian companies.

The requirements regarding prospectus have been brought in line with those applicable to Indian companies. Hence, no application form for shares or debentures can be issued in India by a foreign company without a copy of the prospectus attached to them.

Holding and Subsidiary Companies (Section 4)

“Holding and subsidiary” companies are relative terms. A company is a holding of another if the other is its subsidiary.

According to Section 4 of the Companies Act, a company shall be deemed to be a subsidiary of another, if and only if:

(a) that other controls the composition of its Board of directors; or

(b) that other holds more than half of the nominal value of its equity share capital; or

(c) the first-mentioned company is a subsidiary of any company which is that other’s subsidiary.

To illustrate, company A is subsidiary of company B if, but only if:

(i) company B (holding company) controls the composition of the Board of directors of company A (subsidiary); or

(ii) company B (holding company) controls more than 50% voting power of company A (subsidiary); or

(iii) if company A (the subsidiary) is a subsidiary of the company C which is subsidiary of company B, then company A is a subsidiary of company B.

(d) If company D is the subsidiary of company A, then D will be the subsidiary of company C and also of company B.

For the purpose of clause (a) above, the composition of Board of directors of a company shall be deemed to be controlled by another company if, but only if, the other company can at its discretion appoint or remove all or a majority of directors. The company shall be deemed to have power to appoint a directorship with respect to which any of the following conditions are satisfied, viz:

(a) if a person cannot be appointed to a directorship, without the exercise in his favour by that other company of such a power of appointment;

(b) if a person’s appointment to a directorship follows necessarily from his appointment as director or manager of or to any other office or employment in that other company; or

(c) if the directorship is held by an individual nominated by that other company or by a subsidiary thereof.

C. PROMOTION AND INCORPORATION OF A COMPANY

Any seven or more persons can form a public company and any two or more persons can form a private company. However, the company should be formed for a lawful purpose i.e. it should not be in contravention of the general law of the country. Every company public or private has to be registered with the Registrar of Companies (ROC). The ROC is the authority which besides registration of companies, receives documents and forms from companies and registers them, maintains records of the companies and makes this record available for public inspection as well as ensures that companies by and large comply with the provisions of Companies Act, 1956.

The whole process of the company formation may be divided into three distinct stages, namely:

(i) Promotion;

(ii) Incorporation by Registration; and

(iii) Commencement of Business.

Promotion

"Promotion" is the process of conceiving an idea and developing it into a concrete proposition or project to be accomplished by the incorporation and floatation of a company. The person who takes the necessary steps to accomplish these objectives is known as promoter.

Promoters

In the absence of any legal definition, a promoter has been described as "one who undertakes to form a company with reference to a given object and to set it going, and who takes the necessary steps to accomplish that purpose". Thus, the word "promoter" is used in the common parlance to denote any individual, syndicate, association, partnership or company. In other words, a promoter is one who performs the preliminary duties necessary to bring a company into being and float it. He develops the idea and induces others to join the enterprise.

Functions of a Promoter

The promoter decides the company's name and ascertains that it will be accepted by the Registrar of Companies. He settles the details of the company's Memorandum and Articles, the nomination of director, solicitors, bankers, auditors and secretary of the company and also identifies the registered office of the company. He arranges for the printing of the memorandum and articles, the registration of the company, the issue of prospectus, etc. He is in fact responsible for bringing the company into existence for the object which he has in mind.

Legal Position of a Promoter

While the accurate description of a promoter may be difficult, but his legal position is quite clear. A promoter is neither an agent of, nor a trustee for, the company he promotes because the company is still not in existence. But he stands in a fiduciary relation (relation requiring a confidence or trust) to the company which he promotes. This fiduciary relation requires full disclosure to the company of all the relevant facts including any profit made.

The corollary which the law deduces from this rule of fiduciary relationship is that a promoter may not make, either directly or indirectly, any profit at the expense of the company, he promotes, without the knowledge and consent of the company, and that, if he does make a secret profit in disregard of this rule, the company can compel him to account for it, and surrender the secret profit. When the promoter defrauds the company, he becomes liable for damages and on his death his estate remains liable if it has benefitted from the deceit or breach of trust, but not otherwise.

It is very important to understand that it is not the profit made by the promoter which the law forbids, but the non-disclosure of it. Provided full disclosure is made, as was done in *Salomon & Co. Ltd.* (discussed earlier), the profit is permissible. The disclosure must be made either to an independent Board of Directors or to the shareholders. It must not be half disclosure, if the prospectus states that the promoters are making Rs. 50,000 as profit whereas they are really making Rs. 75,000 the partial concealment falsifies the statement made.

Registration and Incorporation of Companies

Any seven or more persons can form a public company and any two or more persons can form a private company.

The following steps are involved for registration and, incorporation of the company:

(i) Ascertaining availability of name

The first step towards incorporation of a company is to adopt a suitable name. A company is identified by the name with which it is registered. The memorandum of association of a company should, state the name of the company. The name of a company must end with the word “Limited” in the case of a public company and the words “Private Limited” in the case of a private company. By obtaining a licence from the Regional Director, Department of Company Affairs, the requirement as to the addition of the word “Limited” or “Private Limited” to the name may be dispensed with in the case of companies which are to be formed for promoting commerce, art, science, religion, charity or any other useful object and which prohibit payment of dividend to its members.

A company cannot be registered with the name which is undesirable or which is identical to or too nearly resembles the name of an existing company.

For ascertaining as to whether the proposed name is available for adoption, the promoters are required to make an application to the Registrar of Companies of the State in which the registered office of the proposed company is to be situated. A fee of Rs. 500 is to be paid alongwith the application. The Registrar of Companies shall ordinarily furnish the information by way of a letter within 14 days of the receipt of the application. Where the promoters are informed by the Registrar of the availability of name as proposed, such name shall be available for adoption by the promoters of the company for a period of 3 months from the date of intimation by the Registrar.

Therefore, it is necessary that the promoters must within 3 months from the date of name availability intimation, complete all the formalities as to registration. If for any reason, it is not possible to complete the formalities within the said period of three months, the promoters will have to apply to the Registrar for revalidation of the name for a further period of three months and pay a further fee of Rs. 500.

(ii) Preparation of Memorandum of Association and Articles of Association

The Memorandum of Association and Articles of Association are the two important documents which must be prepared by the promoters and filed with the Registrar of Companies for registration of a company.

(a) Memorandum of Association

The second step in the formation of a company is to prepare a document called the Memorandum of Association. This document contains the constitution of a company. It defines the area within which the company can operate, the objects for which the company has been formed, as well as the business that the company would undertake. The memorandum has to be divided into five clauses:

(i) *Name clause:* The first clause of the memorandum states the name of the proposed company. The name is the one which has been approved by the Registrar of Companies. The name of the company must also be painted outside every place where the company carries on business and must be printed on every business document and official letter of the company.

(ii) *Registered office clause:* The memorandum shall mention the State in which the registered office of the company is to be situated.

(iii) *Objects clause:* The third clause states the objects which the proposed company shall pursue. This clause informs the objects i.e. the businesses in which the company shall invest its money.

The objects clause is further divided into two sub-clauses:

(a) *Main objects:* This sub-clause states the main objects to be pursued by the company on its incorporation and the objects incidental or ancillary to the main objects.

(b) *Other objects:* This sub-clause states any other objects which are not included in the first sub-clause.

(iv) *Liability clause:* The fourth clause states the nature of liability that the members incur. This clause states whether the liability of the members shall be limited, and if so, whether limited by shares or by guarantee.

(v) *Capital clause:* The last clause states the amount of capital with which the company is proposed to be registered and the kinds, number and value of shares into which the capital is to be divided.

Subscription: The memorandum concludes with the subscribers declaration that they desire to be formed into a company. The memorandum must be subscribed by at least seven persons in the case of a public company and by at least two persons in the case of a private company, who shall sign the memorandum in the presence of at least one witness.

(b) Articles of Association

The other important document to be filed with the Registrar of Companies for registration is the Articles of Association which contains the regulations relating to the internal management of a company.

The important clauses contained in this document are:

(1) Share Capital and variation of rights.

(2) Lien of company on shares.
(3) Calls on shares.
(4) Share Certificates.
(5) Transfer of shares.
(6) Transmission of shares.
(7) Forfeiture of shares.
(8) Conversion of shares into stock.
(9) Share warrants.
(10) Alteration of share capital.
(11) General meetings.
(12) Proceedings at General Meetings.
(13) Votes by members.
(14) Board of directors and their powers.
(15) Proceedings of Board.
(16) Manager or Secretary.
(17) The Seal.
(18) Dividends and Reserves.
(19) Accounts.
(20) Capitalisation of Profits.
(21) Winding up.
(22) Indemnity.

The Articles constitute a contract between the company and its members and members *inter se* defining their rights, duties and liabilities and are binding on all the members.

Usually, every company has its own Articles of Association. However, if any company does not have its own Articles which is not a compulsory requirement for a public company, then Table A of the First Schedule to the Act will apply. A public company limited by shares can therefore adopt all or any of the regulations contained in Table A in Schedule I. However, a private company must register its own Articles.

The provisions contained in the Articles of Association should not conflict with the provisions of the Companies Act and those in the Memorandum of Association of the company nor should they enlarge the scope of the Memorandum.

The articles of a guarantee company or an unlimited company shall be in any one of the forms contained in Table C (guarantee company not having a share capital), Table D (guarantee company having a share capital) and Table E (unlimited companies) of Schedule I to the Act or in a Form as near thereto as the circumstances may admit.

(iii) Vetting of Memorandum and Articles, Printing, Stamping and Signing of the same

Before getting the Memorandum and Articles of Association of a company printed, it is usual for the promoters to approach the Registrar of Companies concerned for vetting the draft Memorandum and Articles. It has been clarified by the

Department of Company Affairs that though it may not be possible for the Registrars to make definite commitment in this regard, they may offer their help and advice to those who may approach them in drawing up the memorandum and articles. This would be specially desirable in cases where promoters have no prior experience of company formation. For vetting the memorandum and articles, no fees need to be paid by the promoters. The promoters may make a written request on a plain paper enclosing a copy of the draft memorandum and articles and after the vetting by the Registrar, the Memorandum and Articles may be got printed.

The memorandum and articles must be divided into paragraphs and numbered consecutively. They should be stamped according to Stamp Act of the State in which the registered office of the company is to be situated.

Every memorandum should be signed by each subscriber who shall also add his address, description and occupation if any, in the presence of at least one witness who shall attest the signatures of all and shall likewise add his address, description and occupation, if any. In the case of companies having share capital the subscribers to the memorandum should take at least one share each and they have to state clearly the number of shares taken by them.

The articles of association should also be signed separately by the subscribers. The signatures of the subscribers on the articles of association are also to be attested by a witness.

However, it is not necessary that only the subscribers should sign the memorandum and articles. An agent may sign the memorandum on behalf of a subscriber if he is authorised by a Power of Attorney in this behalf.

(iv) Power of Attorney

With a view to fulfilling the various formalities that are required for incorporation of a company, the promoters may appoint an attorney empowering him to carry out alterations, amendments, substitutions, etc., in the Memorandum and Articles of Association and other documents filed with the Registrar as per advice of the Registrar, if any. This requires execution of a Power of Attorney on a non-judicial stamp paper of a value prescribed in the respective State Stamp Laws.

(v) Other documents to be filed with the Registrar of Companies

e-Form No. 32: Consent of directors

In the case of a public limited company having share capital, a person shall not be capable of being appointed a director by the Articles of Association unless, he has, before the registration of the Articles, either himself or through his agent, signed and filed with the Registrar his consent in writing to act as director of the company. Therefore, where the Articles of a public company having share capital name a person as a director, he must file his consent as an attachment to e-Form No. 32 of the Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006.

e-Form No. 18: Notice of registered address

According to Section 146 of the Companies Act, a company must have a registered office within 30 days of incorporation or when it commences business whichever is earlier and give notice to the Registrar of Companies in e-Form No. 18

of the Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006. Where the location of the registered office is finalised prior to incorporation of a company by the promoters, the promoters may also file along with the Memorandum and Articles, the notice of situation of the registered office in e-Form No. 18. Where the location of the registered office is not finalised, e-Form No. 18 should be filed within 30 days of incorporation.

e-Form No. 32: Particulars of directors

Where a company by its Articles of Association appoints any person as a director, manager or secretary it must also file their particulars in e-Form No. 32 of the Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006 with the Registrar at the time of registration. However, e-Form No. 32 can also be filed within 30 days of the registration of the company or appointment of first directors.

(vi) Statutory Declaration in e-Form No. 1

Section 33(2) requires a declaration to be filed with the Registrar in e-Form No.1 of the Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006 alongwith the Memorandum and the Articles of Association. The declaration should be to the effect that all the requirements of the Companies Act and the rules thereunder have been complied with in respect of registration and matters precedent and incidental thereto. The declaration can be signed by an advocate of the Supreme Court or any High Court or an attorney or a pleader entitled to appear before a High Court or a secretary or a chartered accountant in whole time practice in India who is engaged in the formation of the company or by a person named in the Articles as a director, manager or secretary of the company. The Registrar may accept such a declaration as sufficient evidence of such compliance.

(vii) Payment of Registration Fees

The fee prescribed for registration of company is required to be paid to the Registrar. The quantum of registration fee depends on the nominal capital of the company to be incorporated in case of companies having share capital which has been prescribed in Schedule X to the Companies Act.

(viii) Certificate of Incorporation

If the Registrar is satisfied that all requirements, as discussed above, have been complied with, he will register the company and issue the certificate of incorporation. From the date of incorporation mentioned in the certificate of incorporation such of the subscribers of memorandum and other persons, as may from time to time be members of the company, shall be body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to assets of the company in the event of its being wound up as mentioned in the Act (Section 34).

A certificate of incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requirements of the Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorised to be registered and duly registered under the Act.

Commencement of business

As stated above, a company on receiving the certificate of incorporation becomes forthwith capable of exercising all the functions of an incorporated company. A private company or a company having no share capital can commence business and exercise its various powers immediately after it is incorporated.

A public company must, however, obtain a further certificate, known as the Certificate of Commencement of Business, from the Registrar of Companies before it can commence business or exercise borrowing powers. To get this certificate, the company which has issued a prospectus must file the following declarations with the Registrar of Companies:

(i) Shares up to the amount of the minimum subscription have been allotted for cash;

(ii) every director has taken his qualification shares and paid to the company, in cash, an amount equal to the proportion payable on application and allotment on shares offered for public subscription;

(iii) no money is repayable to applicants for shares or debentures by reason of failure on the part of company to apply for, or to obtain permission to deal on a Stock Exchange.

The declaration must be verified by a director or the secretary, or where the company has not appointed a secretary, a secretary in whole time practice.

If a public company having a share capital has not issued a prospectus, the company has to file a statement in lieu of prospectus before it commences business. It should also declare that directors have taken and paid for their qualification shares and the declaration must be verified as above.

The Registrar will examine the documents and if satisfied, will certify that the company is entitled to commence business. The certificate of commencement of business is conclusive evidence that the company is entitled to commence business.

How does a company function?

A company is an association of persons, upon which law confers a personality. It is an artificial person capable of doing many things, which a natural person can do, e.g., it can purchase and own property in its own name, it can enter into contracts, it can sue in its own name and can be sued likewise. In spite of this capacity, it has no physical personality of its own. It can think, express and take decisions only through others who are natural persons and who act in the name and upon the authority of the company. They are the agents of the company, known as its directors, who act together to take decisions for and on behalf of the company. However, to protect the interest of shareholders the Act provides that a number of important decisions of management have to be approved by the shareholders.

The decisions of a company are thus taken by its owners who are the shareholders, (only at their meetings and not acting individually) or by its agents viz. the directors, at their meetings or the meetings of their committees constituted for certain specific purposes.

A meeting may be generally defined as a gathering or assembly or coming

together of two or more persons for transacting any lawful business. There must be at least two persons to constitute a meeting. In certain exceptional circumstances, even one person may constitute a meeting.

Company meetings: The meetings of shareholders, debenture holders, directors or creditors must be convened and held in accordance with the various provisions of the Companies Act.

SELF-TEST QUESTIONS

1. Define the term "company". What are its characteristics?
2. "The fundamental attribute of corporate personality is that the company is a legal entity distinct form the members". Comment.
3. Write short notes on:
   (i) Perpetual succession
   (ii) Transferability of shares
   (iii) Limited liability
   (iv) Corporate personality.
4. Discuss the principles of law laid down by the House of Lords in *Salomon* v. *Salomon and Co. Ltd.*
5. What is corporate veil? State the circumstances under which it can be lifted. Refer to decided cases and provisions of the Companies Act, 1956.
6. State in brief the various kinds of companies which can be registered under the Companies Act, 1956.
7. Define a private company. What are the privileges which are enjoyed by a private company?
8. Write short notes on:
   (i) One-man company
   (ii) Foreign company
   (iii) Holding and Subsidiary companies
   (iv) Government company
   (v) Common Seal.
9. Who are promoters? What is the legal position of a promoter *vis-a-vis* the company?
10. Enumerate the steps involved in the formation of a limited company.
11. Distinguish between a private company and a public company.

Suggested Readings:

(1) Company Administration and Meetings — *S.K. Tuteja*
(2) Company Law — *Sen Gupta*
(3) Company Law — *Avtar Singh*

STUDY VII

ELEMENTS OF COMPANY LAW

A. COMPANY MANAGEMENT—BOARD OF DIRECTORS, MANAGING DIRECTOR, WHOLETIME DIRECTOR, MANAGER, ETC.

DIRECTORS

A company, though a legal entity in the eyes of law, is an artificial person, existing only in contemplation of law. It has no physical existence. It has neither soul nor body of its own. As such, it cannot act in its own person. It can do so only through some human agency. The persons who are in charge of the management of the affairs of a company are termed as directors. They are collectively known as Board of Directors or the Board. The directors are the brain of a company. They occupy a pivotal position in the structure of the company.

Directors take the decision regarding the management of a company collectively in their meetings known as Board Meetings or at the meetings of their committees constituted for certain specific purposes. A meeting of the Board of Directors must be held once in every three calendar months and atleast 4 meetings must be held every year.

The decisions at the Board Meetings are taken by majority of votes but in the case of equal number of votes for and against any resolution, the Chairman has the power to exercise his casting vote for deciding the matter.

Meaning of a Director [Section 2(13)]

As the name implies, a director is one who directs. The Shorter Oxford Dictionary defines a director as “a member of a Board appointed to direct the affairs of a commercial corporation”. The Companies Act makes no attempt to define a director. However, according to Section 2(13) of the Act, a director includes “any person occupying the position of a director by whatever name called”. In any event, it can be said that directors are persons appointed according to the law and authorised to direct, control, conduct or superintend the affairs of the Company.

Who can be a Director?

The Act does not lay down any qualifications for a director except the holding of a specific number of shares, if any, which the articles may fix as a requisite for the appointment of a director. But any provision in the articles of the company which requires a person to hold the qualification shares before his appointment as a director or to obtain them within a shorter time than two months after his appointment as such shall be void. Also the nominal value of the qualification shares should not exceed five thousand rupees, or the nominal value of one share where it exceeds five thousand rupees. If no such share qualification has been laid down in the articles, a director even need not be a member of the company. It follows that any one can be a director, provided he does not suffer from any of the statutory disqualifications stipulated under the Companies Act, 1956.

Who cannot be a Director? (Section 274)

The Companies Act states that a person shall not be capable of being appointed as a director of a company, if

(a) he has been found by the Court to be of unsound mind;

(b) he is an undischarged insolvent;

(c) he has applied to be adjudicated as an insolvent and his application is pending;

(d) he has been convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of expiry of the sentence;

(e) he has failed to pay any call on his shares in the company for six months from the date fixed for the payment;

(f) he has been disqualified by a Court under Section 203 which empowers the Court to restrain fraudulent persons from managing companies; and

(g) such person is already a director of a public company which

(A) has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day or April, 1999; or

(B) has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more:

Provided that such person shall not be eligible to be appointed as a director of any other public company for a period of five years from the date on which such public company, in which he is a director failed to file annual accounts and annual returns under sub-clause (A) or has failed to repay its deposit or interest or redeem its debentures on due date or pay dividend referred to in clause (B).

The Central Government may, however, remove the disqualification incurred by any person by virtue of clause (d) or clause (e) above. A private company, which is not a subsidiary of a public company, may, by its articles, provide for additional disqualifications for a person to be appointed as a director.

Only individuals to be Directors

According to Section 253 of the Act, no body corporate, association or firm can be appointed as director of any company, and only an individual can be so appointed. The effect of this provision is that only individuals (i.e. natural persons) can become the directors of a company.

[*]However, no company shall appoint or re-appoint any individual as director of the company unless he has been allotted a Director Identification Number under Section 266B.

Number of Directors

Every public company shall have at least 3 directors provided that a public company having a paid-up capital of five crore rupees or more and one thousand or more small

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[*] These provisions have not come into force.

shareholders, may have a director elected by such small shareholders in the manner as may be prescribed and every other company shall have at least 2 directors (Section 252). Subject to this statutory limit, the Articles of a company may prescribe the maximum and minimum number of directors for its Board of directors. If the number falls below the minimum, *prima facie* the Board cannot act, unless the Articles allow it to act notwithstanding vacancies.

Any increase in number of directors beyond the maximum permitted by the Articles is to be approved by the Central Government. But where the increase in number does not make the total number of directors more than 12, no approval of the Central Government is needed.

Appointment of Directors

Directors may be appointed:

(a) by a provision in the articles. The first directors are usually named in the articles. However, if they are not so named, the subscribers to the memorandum who are individuals are deemed to be the directors;

(b) by shareholders in general meeting;

(c) by the Board of directors;

(d) by Central Government;

(e) by third parties.

Appointment of First Directors

The first directors are usually named in the articles. If not so named in the articles, the articles may authorise the subscribers to the memorandum to appoint the first directors. In that event the subscribers or majority of them may appoint first directors. If the articles are silent on the matter, Section 254 states that all the subscribers to the memorandum who are individuals are deemed to be the first directors, who will hold office till the first general meeting of the company. If the articles provide for any qualification shares, only such individuals who fulfil that requirement shall be deemed to be the directors.

Appointment by shareholders in General Meeting (Sections 255-256)

In the case of public company or a private company which is a subsidiary of a public company, of the total number of directors only one-third can be permanently appointed. The remaining two thirds must retire by rotation. At each annual general meeting, one third of these two thirds of directors are however eligible for reappointment. Those who have been longest in office retire first. The vacancies thus created by retirement of directors are filled up by shareholders by appointment in the same annual general meeting by means of a majority vote. The shareholders either choose to appoint the retiring directors or some other persons who have given a notice to the company intimating their desire to stand for directorship.

Appointment by the Board

Subject to the provisions of articles, the Board of directors has the power:

(a) to appoint *additional directors* who hold office upto the date of the next Annual General Meeting; (Section 260). However, the total number of directors including the additional directors should not exceed the maximum strength fixed for the Board by the Articles.

(b) to appoint alternate directors to act for a director during his absence for a period of not less than three months from the state in which meetings of Board are ordinary held. The alternate director shall vacate office when the original director returns. (Section 313)

(c) to fill casual vacancies if the office of any director appointed by the company in General Meeting is vacated before the expiry of his term due to death, inability, resignation, etc. The person appointed in casual vacancy shall hold office only upto the date upto which the director in whose place he is appointed would have held office if it had not been so vacated. (Section 262)

Appointment by the Central Government (Section 408)

The Central Government has the power to appoint the directors for the purpose of safeguarding the interests of the company, or its shareholders or the public interest. The number of directors to be appointed has to be specified by the Company Law Board[1]/National Company Law Tribunal[2] (NCLT) if it is satisfied on making a reference to it by the Central Government or on an application of not less than 100 members of the Company or of the members holding 1/10 of the total voting power, that the affairs of the company are being conducted either in a manner which is oppressive to any member of the company or in a manner which is prejudicial to the interests of the company or to the interests of the public. The directors so appointed hold office for a period of three years but can be reappointed by the Central Government for further periods of three years each.

Removal of Directors

The removal of directors rests with the following authorities:

(a) The company in general meeting

(b) The Central Government

(c) The Company Law Board:

(a) *Removal by the company:* Section 284 states that a company may, by ordinary resolution passed in general meeting after special notice, remove a director before the expiry of his period of office. But the following exceptions to the Section are noteworthy:

(a) The Section does not apply to a director appointed by the Central Government.

(b) In the case of a private company, the Section does not authorise the removal of a director holding office for life on April 1, 1952.

(c) It does not apply to a company which has adopted the system of appointing two thirds of its directors by the principle of proportional representation.

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1. Existing
2. Proposed

(d) Directors appointed by financial institutions pursuant to stipulations under their agreements viz., IDBI, IFCI, etc. under their respective Acts.

(e) Directors appointed by Board for Industrial and Financial Reconstruction.

(b) *Removal by the Central Government:* A director may also be removed at the initiative of the Central Government. The Central Government may remove managerial personnel from office on the recommendations of Company Law Board/National Company Law Tribunal.

(c) *Removal by the Company Law Board/National Company Law Tribunal:* When the Company Law Board/National Company Law Tribunal finds on an application made to it for prevention of oppression and mismanagement that a relief ought to be granted, it may terminate or set aside any agreement of the company with a director or managing director or other managerial personnel. When the appointment of a director is so terminated he can not except with the leave of the Board/Tribunal, serve any company in a managerial capacity for a period of five years.

General Powers vested in the Board (Section 291)

The Board of directors is entitled to exercise all such powers and to do all such acts and things as the company is authorised to exercise and do. In the exercise of its powers the board is subjected to the provisions of the Companies Act, the memorandum and the articles and any regulations, not inconsistent with them, made by the company in general meeting.

The powers which are vested in the Board, can be exercised only by the Board. The shareholders cannot interfere in their exercise. Thus if the general powers of management are vested in the directors, the shareholders cannot direct them to bring an action against a particular individual or to sell the assets of the company, or to declare a dividend. The true relationship of the Board "with the general meeting is more of federation than of subordinate and superior."

The powers of the Board of directors are limited in two ways: first being agents of the company, the directors can do nothing that the company itself cannot do under its memorandum, and any *ultra vires* act done by them will be void and ineffective. Secondly, when acting within the power of the company, the powers of the directors are limited to the extent the company has delegated to them by its articles. If they act beyond their own powers but *intra vires* the company, the latter may ratify such acts in general meeting. If these acts are not ratified by the shareholders in general meeting, the directors may be liable to third parties for breach of warranty of authority.

Subject to these limitations, the directors are the exclusive representatives of the company and charged with the administration of its internal affairs and the management and use of its assets. The shareholders cannot usurp the powers which by the articles are vested in the directors. These are, however, exceptions to this rule. Where the directors act *mala fide*, or their personal interest is in conflict with their duty so that they will not take steps to seek redress to the wrong done to the company (being themselves wrong-doers), the majority of the shareholders may take steps to redress the wrong.

Majority of the shareholders may exercise the power vested in the Board in the following exceptional cases:

(a) Where the actions of directors are mala fide, against the interest of the company, the members may reconstitute the Board.

(b) When the Board for some valid reasons becomes incompetent to act, e.g. all the directors may be interested in a contract. In *B.N. Vishwanathan* v. *Tiffins, B.A. and P. Ltd.*, AIR 1953 Mad. 520, the Board had the power to fill up any casual vacancy in the Board. Some casual vacancies occurred on the Board. However, none of the directors constituting the Board was validly appointed. It was held that the casual vacancies could validity be filled by shareholders in general meeting.

(c) When there is a deadlock in the Board i.e., when the members of the Board are equally divided.

Powers to be exercised only at Board Meetings (Section 292)

The following powers of the company can be exercised only by means of resolutions passed at meetings of the Board:

(a) the power to make calls on shareholders in respect of money unpaid on their shares;

(aa) the power to authorise the buy-back referred to in the first proviso to Clause (b) of Sub-section (2) of Section 77A.

(b) the power of issue debentures;

(c) the power to borrow money otherwise than on debentures;

(d) the power to invest the funds of the company; and

(e) the power to make loans.

The Board may, however, by a resolution passed at its meeting delegate the last three powers mentioned in clauses (c), (d) and (e) above, to any committee of directors, the managing director, the manager or any other principal officer of the company. However, the resolution delegating the power must specify the extent to which the delegates can exercise the power.

Managerial personnel

The general principle is that the Board of directors should direct and control the company's affairs. But at the same time the Act allows a person to accept directorship in twenty companies and does not prescribe the time and attention that he should devote to a particular company. Moreover, a Board meeting is a very formal affair and cannot be called very frequently, whereas the business of the company has to be managed every day. Accordingly, the day to day management has to be delegated to "professional management". The duty of the management is to carry out the policy and to attend the day to day conduct of the business of the company. The person appointed to do this may be either one of the directors of the Board and known as a managing director or may not be a director and may be designated as manager or chief executive officer.

A wholetime director on the other hand is a director of the company who is in whole time employment of the company. A company can have one or more whole time directors but in can have only one Managing Director or Manager. A company

cannot have both—a Managing Director and a Manager.

Definition of Managing Director [Section 2(26)]

A managing director, as defined in Section 2(26) of the Act, means "a director who is entrusted with substantial powers of management which would not otherwise be exercisable by him". The term includes a director, occupying the position of a managing director, by whatever name called. The "substantial powers of management" may be conferred upon him by virtue of an agreement with the company or a resolution of the company in general meeting or by virtue of its memorandum or articles.

A managing director exercises such powers, performs such functions and discharges such duties involving substantial powers of management as are assigned to him by the Board of directors and he is required to exercise his powers subject to the superintendence, control and direction of its Board of directors.

A managing director being essentially a director must be an individual.

Disqualifications of Managing Director (Section 267)

According to Section 267 of the Act, no company should appoint or continue the appointment or employment of any person as its managing director or whole-time director, who

(a) is an undischarged insolvent or has at any time been adjudged an insolvent;

(b) suspends or has at any time suspended, payment to his creditors or makes or has at any time made a composition with them; or

(c) is, or has been convicted by a Court of an offence involving moral turpitude.

The disqualifications provided for in Section 267 of the Act are equally applicable to the appointment of whole-time directors also. A whole-time director is a director employed to devote the whole of his time and attention in carrying on the affairs of the company. He cannot be employed elsewhere or be engaged in any other business pursuit. He can, however, be an ordinary director of other companies.

Section 267 of the Act disqualifies all persons convicted, for whatever term of imprisonment or fine, or an offence involving moral turpitude. The expression "moral turpitude" refers to anything done contrary to justice, honesty, principles or good morals.

Manager [Section 2(24)]

As per Section 2(24) of the Act, a manager means "an individual who has the management of the whole or substantially the whole of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called". To be deemed as the manager of a company, the individual must be incharge of the whole business of the company. A mere head of a department or a branch manager is not a manager.

Only an individual can be appointed a manager of a company, whether public or private.

Disqualifications of Manager (Section 385)

Section 385 of the Act prescribes the following disqualifications for a manager:

(a) is an undischarged insolvent, or has at any time within the preceding five years been adjudged an insolvent; or

(b) suspends, or has at any time within the preceding five years suspended payment to his creditors; or

(c) is or has at any time within the preceding five years been convicted of an offence involving moral turpitude.

Tenure of Office of a Managing Director or Manager

The maximum term of appointment of a managing director or manager in a public company or a private company which is a subsidiary of public company, cannot be more than 5 years at a time. Re-appointment, however, can be made for five years at a time. The re-appointment is sanctioned not earlier than two years from the date on which it is to come into force.

B. SHAREHOLDERS

For carrying on its business, a company collects money from the public. The money so collected is called the capital of the company which is usually divided into different units of a fixed amount. These units are called the "shares". The persons who hold the shares of a company are called the shareholders of the company.

The term "share" is defined as a share in the capital of a company. An exhaustive definition of "share" is given by Justice Farewell as "A share is the interest of a shareholder in the company measured by a sum of money for the purpose of liability and dividends in the first place, and of interest in the second; and also consisting of a series of contracts as contained in the articles of association"

In simple words a share indicates the pecuniary interest of shareholders and their rights and liabilities. In this sense it may be defined as an "existing bundle of rights and liabilities".

Under the Companies Act, 1956, a company can issue two types of shares; namely:

(i) Preference share capital and (ii) Equity share capital.

Preference shares carry preferential right as to

(a) payment of dividend during the life time of the company;

(b) repayment of capital on winding up. [Section 85(1)]

Equity shares capital means all share capital which is not preferential in nature. (Section 85)

Another type of equity shares which a company can issue is sweat equity shares. According to Section 79A inserted by the Companies Amendment Act, 1999, "sweat equity shares" mean equity shares issued by the company at a discount or for consideration other than cash for providing knowhow or making available rights in the nature of intellectual property rights or value additions, by whatever name called. All limitations, restrictions and provisions relating to equity shares shall be applicable to sweat equity shares also.

The identity of the company is different from the persons comprising it. The persons comprising a company are the members or the shareholders of the company.

Member is a person who has signed company's Memorandum of Association. Any other person who agrees in writing to become a member and whose name is entered in the company's register of members is also a member of the company.

A shareholder is a person who holds the shares of the company. The term "members" and "shareholders" are used inter changeably and barring a few exceptional cases, they are synonymous. In such cases a member may not be a shareholder or vice-versa.

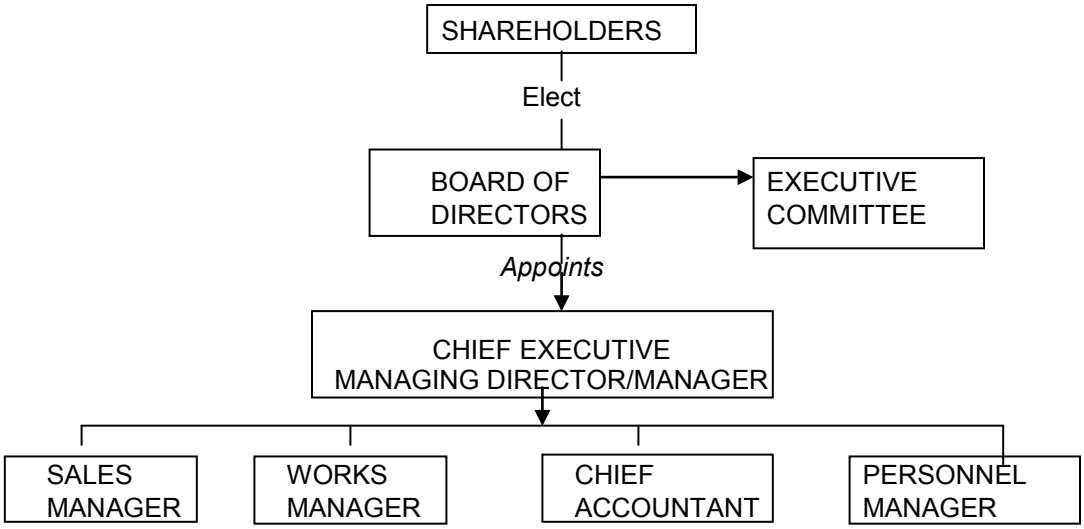
In the following cases a shareholder is not a member of the company;

1. A person having a share warrant is a shareholder but he is not a member. However, he may be treated as member if for specific purpose company's articles so provide.
2. A legal representative of a deceased shareholder is a shareholder even if his name is not entered in the register of members.

Joint Shareholders - The "joint shareholders" are the persons who hold the shares in a company in their joint names.

The shareholders who provide the funds for the company are commonly regarded as the "owners" of the company, its business and property. Legally they are not the owners but have been given some rights and privileges of exercising control over the affairs of the company. They exercise this control by delegating their powers and authority to their elected representatives-members of the Board of Directors. The number of shareholders is generally large. The entire structure of Company management may be depicted as follow:

Structure of Company Management



The government of a company whose shares are widely held may be pictured as proceeding like the sand in an hourglass. At the top are the thousands of shareholders. Then the government narrows down to a dozen or so directors, then still further to the Board's executive committee. The waist represents the chief executive, often the managing director or general manager. Under him are the functional managers, and then a larger group of first-line supervisors or foremen.

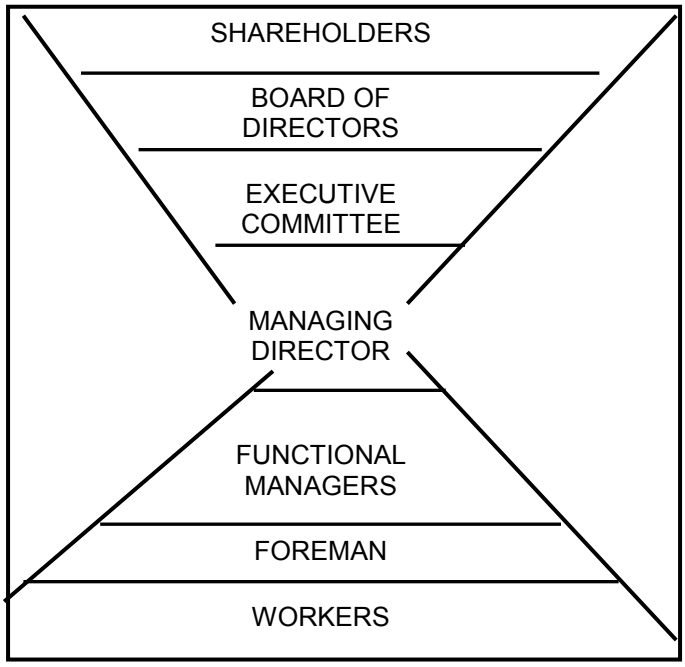
Finally, at the base, we have as many workers perhaps as the shareholders. The figure given below depicts the picture.

It follows that at present the control and management rests with the shareholders, the Board of Directors and either of the two executives mentioned above. Many companies are managed by the Board of Directors alone and no managing director or manager is appointed.

Rights of shareholders: Since the shareholders furnish the funds and bear the risk, they have been given certain rights, both in their individual capacity and as a group. It is as a group, when attending general meetings of the company, that shareholders enjoy the privilege of exercising control over the policy in relation to the working of the company.

Individual Rights: The individual rights of a shareholder include the right to: (i) receive notice of general meetings of the company and to attend those meetings and vote at them either in person or by proxy; (ii) receive dividends, when declared; (iii) transfer his shares, subject to restrictions, if any, imposed by the articles; (iv) inspect registers and records of the company and obtain extracts; (v) apply to the Court to have any variation or abrogation of his rights set aside by the Court; (vi) share in the assets of the company on its dissolution.

Figure depicting Government of the Company



Group Rights: The group rights of the shareholders are of importance from the point of view of the management of the company. Every year at the annual general meeting, the shareholders as a group determine the broad policy of the company. This is actually done when they consider the report of the Board of Directors and approve or disapprove of the policies pursued by the Board. They are entitled to discuss the profit and loss account and the balance sheet of the company and give their approval to the same. These accounts have already been audited by the

auditors appointed by the shareholders at the annual general meeting. They elect directors and declare dividend at a rate as recommended by the Board. They cannot, however, increase the rate.

Where the shareholders feel that there are certain urgent and special matters requiring immediate attention and cannot be left over till the next annual general meeting, they have a right to make requisition for an extraordinary general meeting. If the Board fail to hold the meeting, the shareholders may hold it and transact the special business.

Ordinarily, the management of the company is left to the directors and whole-time officers, but the law requires that the following things to be done only with the consent of the shareholders in a meeting

(a) commencement of any new business (as stated in the memorandum under `other objects').

(b) sale, lease or disposal of the whole, or substantially the whole of the undertaking of the company;

(c) remission of, or granting time for, the repayment of any debt due by a director;

(d) investment of any compensation received by the company for the compulsory acquisition of its undertaking (such consent is not required if the investment is made in trust securities);

(e) borrowing of moneys in excess of the aggregate paid-up capital and its free reserves;

(f) contribution in any year to outside charitable and other funds of amounts exceeding Rs. 25,000 or 5 per cent of the average net profits during the past three financial years, whichever is greater;

(g) appointment of sole selling agents by the Board;

(h) issue of bonus shares;

(i) reorganisation of the capital;

(j) amendment of the memorandum and articles;

(k) voluntary winding up of the company.

It should be remembered in this connection that these powers of the shareholders are the minimum and cannot be taken away or reduced, although they can be enlarged by making suitable provisions in the articles. Furthermore, enhanced powers are given to the shareholders in a meeting in certain important matters inasmuch as they can be transacted only by a special resolution.

Voting Rights of Shareholders

1. *Voting rights of equity shareholders:* A person who holds the equity shares of a company has a right to vote on every resolution placed before the company. His voting right on a poll is in proportion to his share of the paid up equity capital of the Company. (Section 87(1))
2. *Voting rights of preference shareholders:* A person who holds the preference shares of a company does not have a right to vote on every resolution of the

company. He has a right to vote only on those resolutions which directly affect his rights attached to preference shares.

C. MEETINGS

Meaning of a Meeting

A meeting may be generally defined as a gathering or assembly or getting together of a number of persons for transacting any lawful business and not for entertainment or the like purpose. There must be atleast two persons to constitute a meeting. In certain exceptional circumstances, even one person may constitute a meeting. Therefore, one shareholder cannot constitute a company meeting even if he holds proxies for other shareholders.

It is to be noted that every gathering or assembly does not constitute a meeting. Company meetings must be convened and held in perfect compliance with the various provisions of the Companies Act, 1956 and the rules framed thereunder.

Kinds of Company Meetings

Meetings under the Companies Act, 1956 may be classified as:

I. Shareholders' meetings:
   - (i) Statutory Meeting as per Section 165 of the Act.
   - (ii) Annual General Meetings as per Section 166 of the Act.
   - (iii) Extraordinary General Meetings:
     - (a) Convened by directors to transact business of special importance that arises in between the two annual general meetings and justifies the convening and holding a meeting of the shareholders Regulation 47, Table A of Schedule I to the Companies Act; and
     - (b) Convened by directors on the requisitions of the shareholders as per Section 169 of the Act.
   - (iv) Class Meetings of Shareholders.

II. Board Meetings.

III. Meetings of the Board Committees.

IV. Meetings of the debenture holders.

V. Meetings of creditors for purposes other than winding up.

VI. Meetings of creditors for winding up.

VII. Meetings of contributories in winding up.

Statutory Meeting

Section 165 of the Companies Act, 1956 lays down that

"Every company limited by shares, and every company limited by guarantee and having a share capital, shall, within a period of not less than one month nor more than six months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company, which shall be called "the statutory meeting". The provisions of Section 165 are not applicable to a private company.

Statutory Report

Sub-section (2) of Section 165 of the Act prescribes:

“The Board of directors shall, at least twenty-one days before the day on which the meeting is held, forward a report (in the Act referred to as ”the statutory report") to every member of the company:

Provided that if the statutory report is forwarded later than is required above, it shall, notwithstanding that fact, be deemed to have been duly forwarded if it is so agreed to by all the members entitled to attend and vote at the meeting."

Notice of Statutory Meeting

In accordance with the provisions of Section 171 of the Act, notice for calling every general meeting of a company, including a statutory meeting, must be given at least twenty-one clear days before the meeting unless consent is accorded to a shorter notice by members, holding not less than 95% of the paid up capital as gives right to vote or not less than 95% of the total voting power exercisable at the meeting.

Contents of the Statutory Report

Sub-section (3) of Section 165 lays down the contents of the statutory report, which in brief are:

(a) Shares allotted, amounts paid up thereon, and the consideration received, if cash not received on certain shares;

(b) Cash received on shares with an abstract of receipts and payments and balance in hand;

(c) Preliminary expenses of the company—an account or estimate thereof;

(d) Names, addresses and occupations of the directors, auditors, manager and secretary, and changes, if any, since incorporation;

(e) Particulars of contracts or modifications thereof, if any, proposed to be submitted to the meeting for its approval;

(f) The extent, if any, to which each underwriting contract, if any, has not been carried out, and the reasons therefor;

(g) Calls, if any, unpaid by the directors and manager;

(h) Particulars of commission and brokerage paid or payable to the directors or the manager.

Certification of the Statutory Report

Sub-section (4) of Section 165 makes it obligatory that the Statutory Report be certified by at least two directors, including the managing director, if there is one, and also by the company’s auditors in so far as the report relates to the shares allotted by the company, cash received in respect of the shares and the receipts and payments of the company.

Registration of the Statutory Report

In accordance with the provisions of Section 165(5) of the Act, the Board of directors must file a copy of the Statutory Report duly certified as per Sub-section (4), with the Registrar of Companies for registration, after copies thereof have been sent to the shareholders of the company.

Production of list of members at the Statutory Meeting

Section 165(6) states that the Board shall cause a list showing the names, addresses and occupations of the members of the company and the number of shares held by them respectively, to be produced at the commencement of the Statutory meeting and to remain open and accessible to any member of the company during the continuance of the meeting.

Scope of the Statutory Meeting

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

Adjournment of the Statutory Meeting

The Statutory Meeting may adjourn from time to time, and at any adjourned meeting any resolution of which notice has been given in accordance with the provisions of the Act, whether before or after the former meeting, may be passed; and the adjourned meeting shall have the same powers as the original meeting. [Section 165(8)]

Annual General Meeting

A meeting known as an annual general meeting is required to be held by every company, public or private, limited by shares or by guarantee, with or without share capital or unlimited company every year. Section 166(1) of the Companies Act, 1956 states that every company must, in each calendar year hold an annual general meeting, so specified in the notice calling it, provided that not more than 15 months shall elapse between two annual general meetings. However, a company may hold its first annual general meeting within 18 months from the date of its incorporation. In that event it need not hold any annual general meeting in the year of its incorporation or in the following year. Thus, if a company is incorporated in December 2000, it may hold its first annual general meeting in May 2002, and that meeting will be deemed to be the annual general meeting for 2000, 2001 and 2002.

The section contemplates two separate and distinct requirements:

(i) holding the meeting within 15 months
(ii) holding it in each calendar year.

In the event of any difficulty in holding an annual general meeting (except the first annual general meeting), the Registrar may, for any special reason shown, grant an extension of time for holding the meeting by a period not exceeding three months. Application seeking extension of time should be made before the due date for holding annual general meeting. The extension of time granted by the Registrar will apply to both the requirements of the Section.

Time and Place for Holding an Annual General Meeting

Every annual general meeting called within at least 21 clear days' notice must be held on a day other than a public holiday, i.e. it should be held on a working day, during business hours at the Registered Office of the company or at some other place within the city, town or village in which the Registered office of the company is situated. The Central Government may, however, exempt any class of companies

from these provisions.

According to Section 2(38) "public holiday" means a public holiday within the meaning of the Negotiable Instruments Act, 1881. It clarifies that if any day is declared by the Central Government to be a public holiday after the issue of the notice convening such meeting, it shall not be deemed to be a public holiday in relation to the meeting, so that the meeting can be held on that day as scheduled, regardless of the day having been declared as a public holiday.

It is further laid down that a public company or a private company which is a subsidiary of a public company may, by its articles, fix the time for its annual general meetings and may also by a resolution passed in one general meeting, fix the time for its subsequent annual general meetings. A private company, which is not a subsidiary of a public company, may in like manner and also by a resolution agreed to by all the members thereof, fix the time and place for its annual general meeting.

Default in Holding Annual General Meeting

If a company defaults in holding an annual general meeting two consequences will follow.

Firstly, any member may apply to the Company Law Board[1]/Central Government[2] which may call, or direct the calling of the meeting, and give such ancillary or consequential directions as it may consider expedient in relation to the calling, holding and conducting of the meeting. The Company Law Board/Central Government may direct that one member present in person or by proxy shall be deemed to constitute the meeting. A meeting held in pursuance of this order will be deemed to be an annual general meeting of the company (Section 167). It may be noted in this context that at present Company Law Board alone has the power under this section to permit calling of such a meeting, and it excludes the Court's power to extend the time to hold the annual general meeting. However, in the case of sick industrial companies, the operating agency shall be the Tribunal instead of the Central Government.

Secondly, the failure to call this meeting as required by Section 166 of the Act, either generally or in pursuance of the order under Section 167(1) is an offence punishable with fine which may extend to Rs. 50,000, on the company and every officer of the company who is in default and for continuing default, a further fine of Rs.2,500 per day during which the default continues [Section 168].

Business Transacted at an Annual General Meeting

Section 173 of the Companies Act lays down that all business to be transacted at an annual general meeting shall be deemed Special Business with the exception of the business, relating to:

(a) the consideration of the accounts, balance sheet and the reports of the board of directors and auditors;

(b) the declaration of dividend;

(c) the appointment of directors in the place of those retiring; and

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[1] Existing.
[2] Proposed.

(d) the appointment of, and the fixing of remuneration of, the auditors.

Length of the Notice

Section 171 of the Companies Act, 1956 lays down:

(1) A general Meeting (including an annual general meeting) may be called by giving not less than twenty-one day's notice in writing (2) A general meeting may be called after giving shorter notice than that specified in sub-section (1), if consent in the case of an annual general meeting is accorded by all the members entitled to vote thereat. (For Form of consent, See Form No. 22 of General Rules and Forms)

Extraordinary General Meetings

All the general meetings of a company, with the exception of the statutory meeting and the annual general meetings, are called extraordinary general meetings.

Types of Businesses Transacted at Extraordinary General Meetings

As already stated according to the provisions of Section 173 of the Companies Act, 1956, all the company business at the A.G.M. with the exception of business relating to:

(i) the consideration of the accounts, balance sheet and the reports of the Board of directors and auditors,

(ii) the declaration of a dividend,

(iii) the appointment of directors in the places of those retiring, and

(iv) the appointment of, and the fixing of the remuneration of, the auditors

shall be deemed special. In the case of any other meeting, all business shall be deemed special. At extraordinary general meeting only Special Business which arises between two annual general meetings and being urgent and cannot be deferred to the next annual general meeting, is transacted.

Who May Call Extraordinary General Meeting

Usually the articles of association of companies contain provisions with regard to the calling of extraordinary general meetings.

Regulations 47 and 48 in Table A of Schedule I to the Companies Act, 1956 contain the following provisions:

Regulation 47: "All general meetings other than annual general meetings shall be called extraordinary general meetings."

"Regulation 48: "(1) The board may, whenever it thinks fit, call an extraordinary general meeting.

(2) If at any time, there are not within India directors capable of acting who are sufficient in number to form a quorum, any director or any two members of the company may call an extraordinary general meeting in the same manner, as nearly as possible, as that in which such a meeting may be called by the Board."

Calling of Extraordinary General Meeting on Requisition

Under Section 169 of the Companies Act, 1956

(1) The Board of directors of a company shall, on the requisition of such number of members of the company as is specified in Sub-section (4), forthwith proceed duly to call an extraordinary general meeting of the company.

(2) The requisition shall set out the matters for the consideration of which the meeting is to be called, shall be signed by the requisitionists, and shall be deposited at the registered office of the company.

(3) The requisition may consist of several documents in like form, each signed by one or more requisitionists.

(4) The number of members entitled to requisition a meeting in regard to any matter shall be:

(a) In the case of a company having a share capital, such number of them as hold at the date of the deposit of the requisition, not less than one-tenth of such of the paid-up capital of the company as at that date carries the right of voting in regard to that matter;

(b) In the case of a company not having a share capital, such number of them as have at the date of the deposit of the requisition, not less than one-tenth of the total voting power of all the members having at the said date a right of vote in regard to that matter. (For details see Section 169)

Calling of Extraordinary General Meeting by Company Law Board[1]*/National Company Law Tribunal*[2]

Section 186 of the Companies Act, 1956 provides:

(1) If for any reason it is impracticable to call a meeting of a company, other than an annual general meeting, in any manner in which meetings of the company may be called, or to hold or conduct the meeting of the company in the manner prescribed by this Act or the articles, the Company Law Board/National Company Law Tribunal may, either on its own motion or on the application of any director of the company, or of any member of the company who would be entitled to vote at the meeting:

(a) order a meeting of the company to be called, held and conducted in such manner as the CLB/Tribunal thinks fit; and

(b) give such ancillary or consequential directions as the Tribunal thinks expedient, including directions modifying or supplementing in relation to the calling, holding and conducting of the meeting, the operation of the provisions of this Act and of the company's articles.

It should, however, be noted that this section even permits the Court (now Company Law Board) *suo-motu* to call a meeting of the company where it has become impracticable to call a meeting other than an annual general meeting (*Smt. Jain* v. *Delhi Flour Mills Co.* (1974) 44 Comp. Cas. 228).

(2) Any meeting called, held and conducted in accordance with any such order shall, for all purposes, be deemed to be a meeting of the company duly called, held and conducted.

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[1] Existing.
[2] Proposed.

Class Meetings (Section 106)

Class meetings are those meetings which are held by holders of a particulars class of shares, e.g., preference shares. Need for such meetings arises when it is proposed to vary the rights of a particulars class of shares. Thus, for effecting such changes, it is necessary that a separate meeting of the holders of that class of shares is held and the proposed variation is approved at the meeting. For example, for deciding not to pay the arrears of dividends on cumulative preference shares, for which it is necessary to call a meeting of such shareholders and pass the resolution as prescribed by Section 106 of the Act.

Meetings of Debentureholders

When a company issues debentures it provides in the trust deed executed for securing the issue for the holding of meetings of debentures holders and also gives power to them to vary the terms of security or to alter their rights in certain circumstances. All matters connected with the holding, conduct and proceedings of the meetings of the debenture holders are given in the Debenture Trust Deed. The decisions arrived at such meetings with the requisite majority, are valid and binding upon the minority.

Very often a provision is made in the Debenture Trust Deed to dispense with the holding of the meeting of the debenture holders. A provision is made whereby a circular resolution duly signed by the debenture holders would be treated as the decision of the debenture holders. In such a case, it is not necessary to adopt the procedure for convening and holding a meeting of the debentureholders.

Meetings of Creditors

Sometimes, a company, either as running concern or in the event of winding up, has to make certain arrangements with its creditors, which has to be worked out in meetings of creditors. Strictly speaking, meeting of creditors are not company meetings. Sections 391 to 393 of the Act authorise the company to enter into arrangements with the creditors with the sanction of the Tribunal. The Tribunal, on application, may order the holding of a creditors' meeting. If the scheme of arrangement is agreed to by majority in number holding debts to the value of three-fourths of the total value of the debts, the Tribunal may sanction the scheme. A certified copy of the Tribunal's order is then filed with the Registrar and it is binding on all the creditors and the company only after it is filed with the Registrar.

When a company goes into liquidation, a meeting of creditors and of contributories is held to ascertain the total amount due by the company to its creditors and also to appoint a liquidator to wind up the affairs of the company.

Meetings of the Board of Directors

The affairs of a company are managed by the Board of directors. It is, therefore, necessary that the directors should often meet to discuss various matters regarding the management and administration of the affairs of the company in the best interests of the shareholders and the public interest.

Section 291 of the Companies Act, 1956 gives wide powers to the Board of directors. However, Section 292 lays down that the Board shall exercise the following powers on behalf of the company only by means of resolutions passed at

meetings of the board:

(a) Power to make calls on shareholders in respect of unpaid money on their shares;

(aa) the power to authorise the buy back referred to in the first proviso to clause (b) of Sub-section (2) of Section 77A.

(b) power to issue debentures;

(c) power to borrow moneys otherwise than on debentures;

(d) power to invest the funds of the company; and

(e) power to make loans.

Section 285 of the Act prescribes that in the case of every company, a meeting of the board of directors shall be held at least once in every three months and at least four such meetings shall be held in every year. It has been clarified so long as four board meetings are held in a calendar year, one in each quarter, the interval between two meetings may be more than three months. For instance, if a meeting is held on January 1, the next meeting may be held on June 30, the third on 1st July and the fourth on the 31st December.

Notice of Board Meetings

Under Section 286 of the Companies Act, (1) Notice of every meeting of the board of directors of a company shall be given in writing to every director for the time being in India, and at his usual address in India to every other director.

(2) Every officer of the company whose duty it is to give notice as aforesaid and who fails to do so shall be punishable with fine which may extend to one thousand rupees.

No form or time limit of notice or the mode of its service has been prescribed by the Act. However, the Articles of a company may prescribe such time limit. Generally, companies give at least a week's notice. It would, of course, be sufficient compliance with the provisions of Section 286 if, for instance, the directors are duly informed that in future the meetings would be held on first Saturday of every month. But even then the notice of meeting should be given. If notice of the meeting is not properly given, the proceedings at the meeting will be void. Notice must be given even to a director who has stated that he will be unable to attend.

Time and Place of Board Meetings

Unlike the provisions of Section 166, which require the Annual General Meeting of the company to be held at the registered office of the company during the working hours and on a day that is not a public holiday, there are no such restrictions in the Act in regard to the meeting of the Board of directors. The meetings of the Board of directors may, therefore, be held at any place convenient to the directors outside the business hours and even on a public holiday.

D. SECRETARY

Section 383A of the Companies Act, 1956 provides that every company having paid-up share capital of Rs. 2 crores or more must have a whole-time secretary and where the Board of any such company comprises only of two directors, neither of them can act as the secretary of the company.

Definition of Secretary

In order to understand the meaning, importance and also position of a secretary, it would be desirable to examine the definition of the term "secretary". The word "secretary" is derived from the word "secret" implying that there is something confidential and secretive about his job though there is a view that the word "secretary" has been derived from the Latin word "secretaries" which means a notary or scribe. However, the term "secretary" has been defined under Section 2(45) of the Companies Act, 1956 as follows:

"Secretary means a company secretary within the meaning of clause (c) of Sub-section (1) of Section 2 of the Company Secretaries Act, 1980 and includes any other individual possessing the prescribed qualifications and appointed to perform the duties which may be performed by a secretary under this Act or any other ministerial or administrative duties."

Clause (c) of Sub-section (1) of Section 2 of the Company Secretaries Act, 1980 defines a company secretary as a person who is a member of the Institute of Company Secretaries in India.

Thus, secretary has either to be a member of the Institute of Company Secretaries of India or an individual possessing the qualifications as may be prescribed by the Central Government.

Qualifications of a Company Secretary

As mentioned above a company secretary must possess the qualifications prescribed by the Central Government. [Section 2(45)]

The Companies (Appointment and Qualifications of Secretary) Rules, 1988 provide as follows:

(i) Companies having paid-up capital of Rs. 2 crores or more

Rule 2 requires that every company having a paid-up share capital of not less than 2 crores or more must have a whole-time secretary. The person to be appointed as a secretary must be a member of the Institute of Company Secretaries of India.

(ii) In the case of any other company

A company having paid-up share capital of less than Rs. 2 crores may appoint any individual as its whole-time secretary if he possesses one or more of the qualifications specified below:

1. Membership of the Institute of Company Secretaries of India.
2. Pass in the Intermediate examination conducted by the Institute of Company Secretaries of India.
3. M.Com or M.A. in Corporate Secretaryship.
4. Degree in Law by any university.
5. Membership of the Institute of Chartered Accountants of India.
6. Membership of the Institute of Cost and Works Accountants of India.
7. Post Graduate degree or diploma in management sciences granted by university or institutes of Management, Ahmedabad, Calcutta, Bangalore,

Lucknow.

8. Post-graduate diploma in company Secretaryship granted by Institute of Commercial Practice under Delhi Administration or Diploma in Corporate Laws and Management granted by Indian Law Institute, New Delhi.
9. Post-graduate diploma in Company Law and Secretarial Practice granted by the University of Udaipur.
10. Membership of Association of Secretaries and Managers, Calcutta.

However, where the paid-up share capital of such company is increased to Rupees 2 crores or more, the company must appoint a member of the Institute of Company Secretaries of India as its secretary within a period of one year from the date of such increase.

Appointment of a Secretary

We have seen that in terms of Section 383A of the Companies Act, it is necessary to appoint a secretary in a company having a paid-up capital of Rs. 2 crores or more who is an individual possessing the prescribed qualifications, i.e., he should be member of the Institute of Company Secretaries of India.

Provided that every company not required to appoint a whole-time secretary under Sub-section (1) and having a paid-up share capital of ten lakh rupees or more shall file with the Registrar a certificate from a secretary in whole-time practice in such form and in such time and subject to such conditions as may be prescribed by Companies (Compliance Certificate) Rules, 2001, as to whether the company has complied with all the provisions of this Act and a copy of such certificate shall be attached with Board's Report referred to in Section 217.

The secretary being a whole-time employee, his appointment, and remuneration are similar to that of other employees in his cadre in that organisation. Normally, the appointment is done by means of a resolution of the Board as the position of a company secretary is slightly different from that of other officers as he is an officer recognised under the Companies Act, 1956. He is an officer of the Board. In view of the statutory provisions relating to his appointment, it is desirable even though it is not incumbent, that such appointment is made by means of a resolution passed at a meeting of the directors.

Powers of Secretary

The secretary of a company is empowered to perform the following:

(i) All acts which he is required to perform under enactments like the Companies Act, the Income Tax Act, etc.

(ii) All acts which the Board of directors specifically direct him to perform.

(iii) All acts which are essential to enable him to discharge his duties smoothly as the administrative head in his Department.

The powers of the secretary above are conferred on him either under the Act or by the Board or out of his service agreement with the company. At times, the general meetings also authorise him to perform an act. However, if the secretary performs an act without being so authorised the company may not be bound by it.

Duties of a Secretary

Briefly, the contractual, statutory and general duties of a Secretary are enumerated below:

(a) Contractual Duties

1. A company secretary if appointed by an agreement of service, which defines his duties as well as powers, is under a duty to act within the scope of his authority.
2. He is expected to perform his duties with reasonable care and skill.
3. He must abstain from disclosing any confidential or secret information relating to the affairs of the company which comes to his notice during his employment and also not to make any secret profits by virtue of his position as a secretary of the company.

(b) Statutory Duties (Under Various Laws)

(1) *Under the Companies Act*

(i) To sign any document or proceedings requiring authentication by the company. (Section 54)

(ii) To deliver the share or debenture certificate to shareholders within 3 months of allotment or within 2 months of registration of transfer. (Section 113)

(iii) To make entries in the register of members on issue of share warrants. (Section 115)

(iv) To make available trust deed for inspection to every member or debenture holder and to forward a copy of it to the members or debenture holders on their request within 7 days of request on payment of prescribed fee. (Section 118)

(v) To deliver for registration particulars of mortgages and charges to the Registrar. (Sections 125-137)

(vi) To get painted or get affixed the name plate of the Company outside every office or the place of its business, to get it printed on documents of the company and to get it engraved on the seal of the company. (Section 147)

(vii) To make a statutory declaration for obtaining the certificate of commencement of business. (Section 149)

(viii) To sign the Annual Return. (Section 161)

(ix) To allow inspection of and to furnish copies of register of members and register of debenture holders. (Section 163).

(x) To send notices of general meetings to every member of the company. (Section 171)

(xi) To file resolutions and agreements requiring registration with the Registrar. (Section 192)

(xii) To prepare and record minutes of every general meeting and of every meeting of Board of directors or of every committee of the Board within 30 days of the conclusion of every such meeting. (Section 193)

(xiii) To make available for inspection minute books of general meeting. (Section 196)

(xiv) To sign the annual balance sheet of the company. (Section 215)

(xv) To send notices of the Meetings of Directors. (Section 286)

(xvi) To make available register of directors for inspection. (Section 304)

(xvii) To assist in preparing the statement of affairs in a winding up for the purpose of submitting it to the liquidator. (Section 545)

(xviii) To maintain the following statutory books

(1) Register of investments held by company in the name of its nominees. (Section 49)

(2) Register of charges. (Section 143)

(3) Register of members. (Section 150)

(4) Register of index of debentureholders. (Section 152)

(5) Register of contracts in which directors are interested. (Section 301)

(6) Register of Directors, Managers, and Secretary. (Section 303)

(7) Register of Director's shareholdings. (Section 307)

(2) Under the Income-tax Act

A company secretary is a `Principal Officer' of the company under Section 2(35) of the Income-tax Act, 1961. The Act imposes certain obligations upon him:

1. To ensure that proper income-tax is deducted at source from the salaries paid to the employees, or interest paid/payable to debentureholders or depositors.
2. To see that a certificate of income-tax deducted at source is furnished to every debentureholder or depositor.
3. To ensure that the tax so deducted has been deposited in Government treasury.
4. To verify and submit miscellaneous statements, forms and returns.

(3) Under the Indian Stamp Act

It is the duty of the secretary to see that documents like letters of allotment, share certificates, share warrants, debenture certificates and transfer forms, etc., are properly stamped as per the requirements of the Indian Stamp Act.

(4) Under Other Acts

In addition to the above, the Secretary is also required to perform the various duties specified under The Industrial Disputes Act, 1947, The Employees' State Insurance Act, 1948, The Minimum Wages Act, 1948, The Payment of Wages Act, 1936, The Factories Act, 1948, The Employees' Provident Funds and Misc. Provisions Act, 1952, The Foreign Exchange Management Act, 1999, The Securities and Exchange Board of India Act, 1992 (SEBI) and The Securities Contracts (Regulation) Act, 1956.

Role of Secretary in a Company

Generally speaking, the role of a secretary is threefold, viz., as a statutory officer, as a co-ordinator and as an administrative officer. Similarly, the responsibility of a company secretary extends not only to the company, but also to its shareholders,

depositors, creditors, employees, consumers, society and the Government.

Thus a company secretary plays a vital role in company administration. His role can conveniently be studied from three different angles:

(a) as a statutory officer;

(b) as a coordinator;

(c) as an administrative officer.

(a) Statutory Officer

According to Companies (Amendment) Act, 2000 the term "officer" includes any director, manager or secretary or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act [Section 2(30)]. Hence we see that the company secretary is an officer responsible for compliance with numerous legal requirements under the Companies Act, 1956 and other statutes applicable to companies. Under the Companies Act, 1956 he is responsible for performance of the duties of a secretary and such other ministerial and administrative duties as may be assigned to him [Section 2(45)]. As per Section 5 of the Companies Act, 1956 he is an officer who is in default and is liable for any non-compliance of legal provisions under the Companies Act which hold the officers who are in default liable.

Section 2(45) of the Companies Act provides that `Ministerial and Administrative duties' can be assigned to him. This indicates that a secretary can be assigned managerial duties in addition to his statutory duties. The various provisions and rules named under the Companies Act make it obligatory for the Secretary to sign the annual return filed with the Registrar [Section 161(1)], make declarations regarding commencement of business (Section 149), authenticate the Balance Sheet and Profit and Loss Account (Section 215) and to make declaration under Section 33(2) of the Act before incorporation of a company confirming that all the requirements of the Act and the Rules therein have been compiled in respect of registration of a company and the Registrar may accept such a declaration as sufficient evidence of such compliance.

Under the Indian Stamp Act, it is the duty of a Secretary to see that the documents such as letter of allotment, share certificate, debentures, mortgages are issued duly stamped. He is the principal officer under Section 2(35) of the Income-tax Act, 1961.

Thus, the responsibility of a secretary as a statutory officer has been expanded by the enactment of various economic legislations, like Industries (Development and Regulation) Act and Foreign Exchange Regulation Act. Accordingly, the numerous provisions which the company is obliged to comply with makes the Secretary's job onerous and difficult. The duties imposed upon a secretary by various statutes clearly indicates the important place that he occupies in corporate administrative hierarchy.

(b) Co-ordinator

The Company Secretary as a co-ordinator has an important role to play in the administration of a company's business and affairs. It is for the secretary to ensure

effective execution and implementation of the management policies laid out by the Board. The position that the Company Secretary occupies in the administrative set up of the Company makes his function as one of co-ordinator and link between the top management and other levels. He is not only the communicating channel between the Board and the executives but he also co-ordinates the actions of other executives vis-a-vis the Board. The ambit of his role as a co-ordinator also extends beyond the company and he is the link between the company, its shareholders, society and the Government. Thus, the role of a company secretary as a co-ordinator has two aspects, namely internal and external. The internal role of a co-ordinator extends to the Board including the Chairman and Managing Director, various line and staff functions, the trade unions and the auditors of the company. His role as an external co-ordinator extends to the relationship of the company with shareholders, Government and Society.

Where, the company has a Managing Director, he must seek his guidance and instructions regarding implementation of the policies laid down by the Board and also on matters arising out of the implementation of the decisions. He is also required to keep the chairman and the managing director apprised of changes made in the Government Policies/Acts, obligations under various statues and to give balanced advice on matters which have legal ramifications.

Relationship with other Functionaries

We have seen that the Secretary is responsible for conveying the Board's decisions on various aspects of the company's policies to the persons incharge of such functions. He is, in addition, responsible to ensure that the returns and reports received from various operational executives are submitted in time complete in all respects, and do not conflict with the corporate objectives.

Even where different persons are in-charge of other functions, e.g., sales, personnel, etc., it is usually the Secretary who normally communicates with outside agencies, particularly with government and semi-government bodies to ensure that the information given to various agencies do not conflict with each other and are in accordance with the statutory requirements and corporate objectives of the organisation.

Trade Union

Where the Secretary is responsible either directly or through his assistants for industrial relations, he must be very careful with trade union officials whether they belong to recognised unions or not. He must ensure that proper notes are kept of the discussions and negotiations and all decisions arrived at during such negotiations. Whenever long term settlement with recognised unions is finalised he should see that the agreement embodying these settlements are in accordance with the relevant statutes applicable.

It is the responsibility of the Secretary to ensure compliance with the provisions of various labour legislations such as Industrial Disputes Act, 1947, Employees' Provident Funds and Miscellaneous Provisions Act, 1952, Payment of Bonus Act,

1965, Payment of Gratuity Act, 1972, Payment of Wages Act, 1936, etc.

Whilst he must ensure that the employees guilty of misconduct are charge-sheeted and punished but before doing so all formalities, e.g., holding of enquiries, etc., must be scrupulously followed. He should see that industrial labour relations are always cordial and he should ensure that various creative activities of the employees are encouraged wherever possible by grants and subsidies from the company.

Shareholders

The relationship with the shareholders is an important sphere of his co-ordinating role and, therefore, the Secretary will have to maintain proper relationship with the shareholders of the company.

He should ensure that there is no delay in the inspection of books and registers required by a shareholder provided all formalities are complied with. He must ensure that extracts of registers demanded by shareholders are furnished to them within the statutory periods.

However, the most important thing for a Secretary is to ensure that all correspondence from shareholders is dealt with promptly, and their queries are answered as far as possible keeping the statutory provisions in mind. As part of public relations he should be able to attend to the shareholders who personally come for information, to furnish documents or details or any other matter as the image of the company will, to a great extent, depend on the relationship of the Secretary with the shareholders.

Government

We have seen earlier that all information and correspondence with the Government are normally coordinated or routed through the Secretary to ensure uniform reporting. The Secretary has a very important role vis-a-vis the Government. He should endeavour to have information on Government policies and programmes in advance wherever possible to ensure effective implementation. Good relationship with the Government can be developed where the company sincerely tried to implement various statues both in law and spirit.

Community

In recent years the responsibility of a company towards society has become very important since the company has to function within the parameters of the environment of the country. With this in view, a number of companies have undertaken rural development including adoption of villages and have built schools, colleges and hospitals to cater to the needs of society. In respect of companies in consumer goods industry, it is necessary to project that the products and their prices are in consonance with the standards expected by the consumers. Arising out of such social responsibility many companies have also allowed small sectors to manufacture ancillaries and raw materials required by the organisation for promotion of employment opportunities.

(c) Administrative Officer

The principal duty of a secretary as an administrator is to ensure that the activities of a company are in conformity with the company's policy. In his role as an administrator, the secretary provides the very foundation on which the entire structure of company administration is constructed.

The role of company secretary can be subdivided into organisational, financial, office and personnel administration.

Organisational Administration

Since the secretary has an opportunity of looking at the entire organisation with some amount of detachment, he has the scope to advise the top management including the Board of directors on the need to develop a good structure. Since the secretary collects, interprets and assimilates information relating to all aspects of business to aid and assist the board in carrying out its function, he therefore, gets an opportunity to know the strengths and the weaknesses of the functional executives.

In his role as administrator, he has to make a detailed analysis of various activities, decision-making machinery, inter-relations of departments and functions. He has, therefore, to ensure that the organisational structure must always be kept under constant study. The making of such examination and study and the consequent advice and recommendation for making changes is a task which the company secretary has to perform.

Financial Administration

Since various monthly and periodical operating reports and financial statements are routed for consideration of the board through the secretary, he should analytically study these statements. Thus as a secretary to the Board, the Company Secretary has in consultation with the Finance Manager to devise suitable and proper systems of accounting procedure, internal control and internal audit with a view to safeguard the company's funds. The Company Secretary should have a good knowledge of budgetary control and procedures, accounts and other related matters. He is also expected to be proficient in dealing with matters connected with taxation.

The Company Secretary is generally assisted by Chief Accountants in the discharge of his functions relating to financial administration. In many companies, the Secretary is also the Chief Accountant. He has to negotiate with banks and financial institutions the terms of finance both for working capital requirements and capital expenditure.

Office Administration

In all big companies, the office administration is carried on by an officer called the Office Manager who generally reports to the Company Secretary. It is the duty of the Secretary to ensure that different departments of the office are properly staffed, organised, co-ordinated and supervised.

He has to review from time to time, the various procedures and systems with a view to making the administration effective. In the discharge of these functions, he is normally assisted by organisation methods section of the organisation. He is also responsible in most organisations for office services including transport. The image of

a company depends on the design and office layout from the reception to the records. The Secretary has not only to ensure that these services are maintained and increased but also to ensure that the cost of such services is reviewed from time to time.

Personnel Administration

Personnel Administration includes recruitment, training, payment, promotion, retirement, discharge and dismissal of staff. This is a very important and at the same time a difficult task to administer. Whilst in big organisations there may be a separate personnel manager or officer, in smaller companies the Secretary may be called upon to advise and assist the directors on principles and legal points involved in this area of administration.

Administration - Company's Properties

The Secretary has an important role to play in safeguarding the company's interest in property matters, ensure all properties are properly maintained and insured and keep a suitable register for each property containing relevant information. He should have a good knowledge of relevant rules and by-laws applicable to property. He should also ensure that registration of trade marks, patents, licences is done from time to time and legal action is taken in respect of infringement of such industrial rights.

Corporate Records

The secretary is required to maintain certain records in addition to those under the Companies Act. The volume, the method and the procedure will vary with the size and nature of the company.

The secretary has also to ensure that the statutory time limits relating to directors and shareholders meetings, payment of dividend and interest, filing of returns under the Companies Act, 1956, Income-tax Act and Sales-tax Act, etc., are adhered to and formalities under stock exchange regulations are compiled with. He must also ensure timely renewal of contracts and leases.

Personnel and Property

The secretary has to ensure that adequate system of security of personnel based on technical advice are available in the factory and office. He is also responsible for devising and maintenance of systems to safeguard the valuable company records, or information against loss, theft, fire, etc. He is to review from time to time to ensure that the properties of the company are adequately insured. The company secretary should have good knowledge of insurance law and practice.

Whilst the above discussion only gives a brief outline, the duties and responsibilities of the company secretary are subject to continuous change and has, therefore, to be reviewed from time to time to ensure that he effectively contributes in respect of the above matters. He should, therefore, keep himself abreast of legal changes and practice.

SELF-TEST QUESTIONS

1. Define a director. Who cannot be a director? Can a firm or a company be a director?

2. Write short notes on:
   (a) Managing Director
   (b) Whole-time Director
   (c) Manager.
3. How are the first directors of a company appointed?
4. Can the Central Government appoint directors in a company.
5. Who has the power to remove directors duly appointed on the Board of a company.
6. Enumerate the powers to be exercised by the Board only at their meetings.
7. Explain the term "Secretary" under the Companies Act, 1956. Is it necessary for every company to have a Secretary?
8. State the qualifications which a Company Secretary should possess.
9. Discuss the role of a Company Secretary as a statutory officer, as a co-ordinator and as a administrative officer.
10. Enumerate briefly the duties of a Company Secretary.
11. What is a statutory meeting? State the contents of Statutory Report.
12. What is an Extraordinary General Meeting? Who can call such a meeting?
13. Briefly describe the rules governing the time and place of Board Meetings.

Suggested Readings:

(1) Company Administration and Meetings—*S.K. Tuteja*
(2) Company Law—*B.K. Sen Gupta*
(3) Company Law—*Avtar Singh*

PART B - ELEMENTS OF MANAGEMENT

STUDY VIII

NATURE OF MANAGEMENT AND ITS PROCESS

The Concept

In the present-day society human needs are largely satisfied through the economic activities of organised groups and associations. Because of biological and other limitations, no individual or group can afford to be self-sufficient and yet attain a high level of prosperity. It is, therefore, in their own interest that men should join together and accomplish goals through cooperation. However, to be effective with minimum of adverse consequences, it is essential that group efforts should be properly organised, directed and coordinated, i.e., there is need for management.

The word “management” is a singularly difficult one. It denotes not only a function but also the people who discharge it. It denotes not only a special position and rank but also a discipline and field of study. Management is the specific organ of the modern institution on which the performance and survival of the institution depends. It is the function of management to use all resources, available to an organization, for the realization of results in such a way that the business firm is not only able to pave its way but also able to earn some surplus to meet the needs of growth and expansion. It is the management that provides planning, organisation and direction which are necessary for business operations. In a more important sense, management is a vital function concerned with all aspects of the working of an enterprise. It identifies a special group of people who direct efforts towards common objectives through the activities of other people. Management, in this sense, may be defined as the art of getting things done. Hick defines management as “the process of getting things done by the people and through the people”. Massie defines management as “the process by which cooperative group directs actions toward common goals. This process involves techniques by which a distinguishable group of people coordinate activities of other people, managers seldom actually perform the activities themselves”.

Koontz and O’Donnel state that management means “getting things done through and with people”. Haimann observes that “management is the function of getting things done through people and directing the efforts of individuals towards a common objective”. On the basis of all the definitions given above we may say that management is a process by which responsible people in an organisation get things done through the efforts of other people in grouped activities.

Schools of Management

Many management scholars and practitioners believe that the theories on management are aimed at establishing the best way of doing things. But it is to be appreciated that “management theory and science do not advocate the best way to do things in the light of every situation”. In fact, they are meant as a search for fundamental relationships for basic techniques and for organisation of available knowledge based on understanding of the concept. And undenyingly the situational need determines their mode of application. Clearly therefore, effective management is always situational management-the application of knowledge to realities with a

view to attaining desired results.

However, after World War II, the literature on management has grown at an unprecedented rate. This, in turn, has greatly helped in improving research, teaching and practice. But such a growth has also added to differences of opinion and controversies. Ranging from the operational school of management thought to the mathematical school, one comes across the human behaviour school, the systems school and the decision theory school. These divergent views relating to management have made the task of defining management extremely difficult. In the following paragraphs we present a brief review of some approaches to management analysis.

(i) The Empirical Approach

Scholars belonging to this school believe that clear understanding of the management theories can only be developed by the study and analysis of cases and comparative approach. They have a strong conviction that it is through the study of successes and failures of managers in individual instances and their endeavour to solve specific problems, that it is possible to apply effective techniques in comparable situations. In their approach they intend to make some generalisations from case study with a view to establishing theories as useful guides for future course of action.

(ii) The Interpersonal Behaviour Approach

Since managing involves getting things done with and through people, scholars belonging to this school feel that study of management should be based on interpersonal relations. This approach is termed as 'behavioural science', 'leadership' or 'human relations' approach by different group of scholars. In the presentation and study of the theories, this school attached significance to interpersonal relations, personality dynamics, relations of the cultures of individuals and groups. In other words, this approach leans too heavily on the human aspect of management. Their attention is primarily on individual and his or her motivations as a socio-psychological being.

(iii) The Group Behaviour Approach

In fact, this approach is closely related to interpersonal behaviour approach. But this school of thought has basically centered on studying the behavioural pattern of members and groups in an organisation. The ultimate objective is to indicate the ways of achieving relatively effective organisational behaviour. Belief and thinking of the scholars of this group approach move around the behavioural dynamics of small and large groups in any organisation. That apart, recognition of the organised enterprise as a social organism, institutional foundations of organisation authority, influence of formal organisation and social factors are the main areas of their attention which considerably helped management practitioners in their real life situation.

(iv) The Decision Theory Approach

The exponents of the decision theory emphasise that decision-making is the core of management. They concentrate on rational decision making, selection from among possible alternatives of a course of action or policy. The approach of this school of

opinion is concerned with the persons, or organisational groups making the decision, or with the analysis of the decision making process. Besides the economic rationale of decisions, attempt is also made in this theory to cover the social and psychological aspects and environment of the decisions and the decision-makers.

(v) The Mathematical Approach

There cannot be any two opinions that mathematical tools and methods can be used by any school of management. But some management scholars and practitioners have viewed management exclusively as a system of mathematical models and processes. Operation researchers and analysts primarily belong to this group. They are of the opinion that if planning, decision-making, organising, etc., conform to logical processes then the same can easily and suitably be presented in mathematical symbols. The leaning of this school is heavily on expressing and interpreting the basic relationship of the problems in terms of determined goals. In a way, it is thus closely related to decision theory approach but unrelated in the sense that it emphasizes extensive use of mathematics in management.

(vi) The Operational Approach

This approach consolidated the vital thinking of all the approaches to management in order to identify and highlight what relates to actual managing and which can be most useful in real life situations. The operational approach thus fundamentally recognises that "there is a central core of knowledge about managing which exists only in managements". Its applicability can be brought to bear at all levels of management irrespective of the nature and size of the organisation. But at the same time this approach does recognize that the problems faced by the executives and managers in their real life normally vary with the nature, size and level of enterprise. Further, operationalists have drawn and developed their concepts from all possible disciplines which have direct or indirect effect on human behaviour and organisational functioning. And in this way, the basic theory for the various facets of management has generally been established.

Thus, it may be seen from the above that the various approaches to interpret the term management may at best be described as "window" in as much as they emphasize a particular aspect of management while portraying its total picture. That management draws heavily from a variety of disciplines further creates interpretational problems. Nevertheless, the various approaches described above encourage holistic, not partisan appreciation of the concept whose emergence has been described as having even more profound influence than in the industrial revolution.

The Management Functions

Functions relating to activities such as producing, purchasing, selling, advertising, accounting and engineering differ from one enterprise to the other. However, the functions of management are common to all business units and even non-profit organisations. Now, the problem before us is to know these functions in some details. Henri Fayol[1], the French industrialist and popularly known as the founder of modern management theory, divided all activities of industrial undertakings into six groups:

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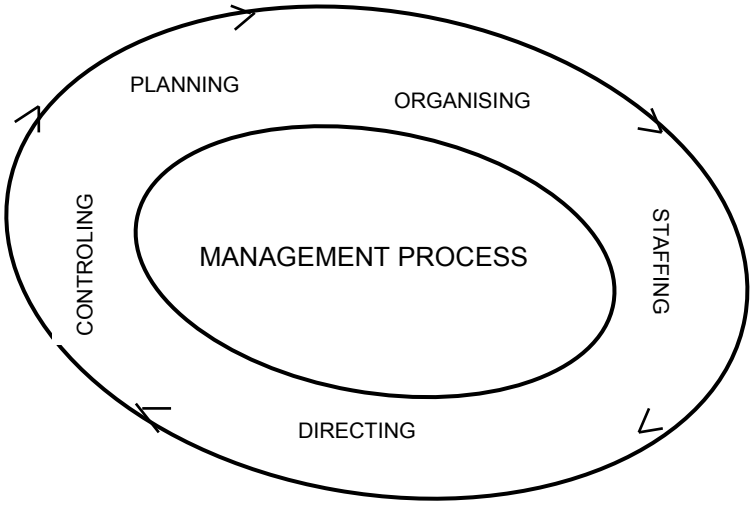
[1] Henri Fayol, "General and Industrial Management".

1. Technical 2. Commercial
3. Financial 4. Security
5. Accounting 6. Managerial

Fayol distinguished between principles and elements of management, using the former for rules and guides, and the elements of management for its functions. He grouped these elements into five managerial functions as (1) Planning, (2) Organising, (3) Commanding, (4) Coordinating, and (5) Controlling. Fayol's classification of managerial functions is widely acknowledged and acclaimed, though other classifications also exist. For example, Luther Gulick[2] coined the word POSDCORB using the initial letters of management functions: planning (P), organising (O), staffing (S), directing (D), coordinating (CO), reporting (R), and budgeting (B). Reporting is a part of control function, while budgeting represents both planning and controlling. Similarly, Newmann and Summer classified managing process as the functions of (i) organising, (ii) planning, (iii) leading, and (iv) controlling. Still another useful method of classifying managerial functions is to group them around the components of planning, organising, staffing, directing and controlling. Circular flow of these functions may be presented as follows:



The above functions of management are common to all business enterprises and organisations in other fields but the manner in which these are carried out will not be the same in different organisations. Similarly, though all these functions constitute the job of a manager, relative importance of each of them will vary from time to time as well as across the hierarchial levels.

Thus economic conditions might force a firm to lay more emphasis on control for the time being, while a growing concern may have to devote more time to organisational problems. Likewise, top management is generally required to spend more time in planning, the middle level on organising and the lower level managers may be more concerned with directing.

Planning

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[2] Quoted by Earnest Dale in his work "management Theory and Practice.

Planning is deciding in advance what is to be done, how and when it is to be done. It involves projecting the future course of action for the business as a whole and also for different sections within it. Planning is thus the preparatory step for actions and helps in bridging the gap between the present and the future. Since planning is essentially choosing, it is dependent upon the availability of alternatives. It is through this process of choosing that decision-making can obviously be seen as an important aspect of planning. Thus, planning is an intellectual process and signifies use of rational approach to solution of the problem.

In a more realistic sense, planning process comprises determination and laying down of (i) objectives, (ii) policies, (iii) procedures, (iv) rules, (v) programmes, (vi) budget, and (vii) strategies. Management might plan for a short period and also for long-run. For improved efficiency and better results, short-range plans should be properly coordinated with long-range plans.

Planning is a fundamental function of management and all other functions of management are greatly influenced by planning process. Importance of planning is amply manifested by increasing interest evinced in planning in business, government and other organisations. Very often planning process is erroneously described to be the prerogative of top management. But the fact is that planning permeates all levels in the organisation and every manager irrespective of his position in the management hierarchy must plan within the limits of his authority and decisions of his seniors.

Organising

Organising is concerned with both the “orderly” assemblage of human and material resources as well as the process of development of a structure of formally identified and distinguished tasks, roles and relationships that may be attributable to the various members so that they may effectively work as a group. In the latter sense, it consists of the following steps:

(1) Determination of activities of the enterprise keeping in view its objectives.

(2) Classification of such activities into convenient groups for the purpose of division.

(3) Assignment of these groups of activities to individuals.

(4) Delegation of authority and fixing of responsibility for carrying out the assigned duties.

(5) Coordination of these activities and authority relations throughout the organisation.

Thus, division of work among people and coordination of their efforts to achieve specific objectives are the fundamental aspects of organisation.

It needs no mention that the problem of organising arises only when group efforts are involved. One man activities cannot possibly be organised in the sense in which we use this term. Similarly, organisation is always intended to achieve objectives and as such it is a means to an end and never an end in itself. For better results therefore, it is implied that organisation should be based upon practical prudence and sound applications of organisational principles.

Staffing

Organisation as a function of management helps the executive to establish

positions and lay down their functional relations to each other. However, it is through staffing function, the different positions in the organisation structure are kept manned. Staffing process, therefore, provides the organisation with adequate number of competent and qualified personnel at all levels in the enterprise. Since successful performance by individual largely determines success of the structure, staffing function of the manager deserves sufficient care and attention of the management. It implies that managers should properly estimate manpower requirements of the organisation consistent with qualifications expected for proper and efficient discharge of duties on existing and possible jobs in the organisation, laying down of suitable selection and placement procedures, developing employee skill through training and appraisal schemes, and devising suitable schemes of compensation.

Staffing is a continuous function. A new enterprise needs to employ people to fill positions established in the organisation. In an established concern also such factors as death, retirement, resignation, termination, promotion, demotion, transfer, change in objectives as well as methods, etc., necessitate continuous performance of this function.

Direction

Mere planning, organising and staffing are not sufficient to set the tasks in motion. Management may have well coordinated plans, properly established duties and authority relations and able personnel, yet it is through the function of direction that managers are able to get the employees accomplish their tasks by making them integrate their individual efforts with the interest and objectives of the enterprise. It calls for properly motivating, communicating, leading and supervising the subordinates.

Along these broad aspects, directing the subordinates embraces the following activities.

(i) issuing orders and instructions;

(ii) guiding, counselling and instructing the subordinates about the proper way of doing the job;

(iii) supervising the work of subordinates to ensure that their performance conforms to the plan;

(iv) motivating the subordinates to direct their behaviour towards accomplishing organisational objectives;

(v) maintaining discipline and rewarding effective performance.

Control

While directing, the manager explains to subordinates the work expected of each of them and also helps them to do their respective jobs so that enterprise objectives can be achieved according to best of their abilities, but even then there is no guarantee that work will always proceed according to plans, and this possibility of drifting away from plans calls for constant observation of actual performance so that appropriate steps may be taken to cause the events conform to plans. The important steps to be initiated in this regard are as follows :

(i) Measurement of actual performance against the standard and recording deviations.

(ii) Analysing and probing the reasons for such deviations.

(iii) Fixing of responsibility in terms of person responsible for negative deviations.

(iv) Correction of employee performance so that group goals and plans devised to attain them are accomplished.

Control is thus closely related to the planning job of the manager. But it should not be viewed merely as a post-mortem of past achievements and performance. In fact, a good control system should suggest corrective measures so that negative deviations may not re-occur in future. The principle of feedback when incorporated in the system can be of great use in this regard.

Innovations and the Manager

Business conditions, both internal and external, do not remain constant for long. A true manager therefore, cannot continue to manage the same way as he has been doing it in the past. Considerations of efficiency and survival require that a manager should be constantly engaged in the task of innovation i.e. introducing new changes. In this sense, management is a creative and also an adaptive process. A manager may be innovative by developing new ideas, adapting ideas from other fields to his own use, combining old ideas into new ones, or even by making subordinates develop new ideas.

Some authorities emphasis the managerial task of innovation so as to suggest it to be a separate function of management. In it there seems to be an attempt to introduce entrepreneurial task into the managerial job and thus make the manager an innovator in the Schumpeterian sense. Thus, there is a talk of intra-firm entrepreneurship, now widely known as intrapreneurship. That management should be creative is an easily acceptable proposition. However, to emphasise innovation to the extent of regarding it a distinct function of management is debatable. The fact is that planning function includes innovation because in the event of planning the manager not only adjusts his organisation according to future conditions but also attempts to effect changes in these conditions.

Sometimes, communication is also described as a separate function of management. Every manager communicates both horizontally and vertically and a larger part of his time is spent in transmission and understanding of information. But communication is only a sub-function. In order to direct his subordinates, a manager not only guides, leads and motivates them but also communicates with them. Communication is then part of direction function.

Sometimes a question is raised about the order in which different functions of planning, organising, staffing, direction and control are performed. Theoretically planning is done first followed by organising, staffing, direction and control. However, since management is a dynamic process where all its functions are repeated and performed continuously, no such order in practice is adhered to and followed. It is, therefore, futile to insist on any time or order sequence for different functions of management.

Goals of a Manager

Traditionally it has been believed that managers act as convenient subordinates to the masters of industry and as such pursue their (owners') goal of profit maximisation. Reasoning offered was that since they are employed by the owners, risk of losing jobs would compel them to the single-minded pursuit of absentee

owner's objective. However, with the widening divorce of management from ownership and with the growing professionalisation of management, it is not difficult to understand that managers may have objectives of their own which may even be in conflict with those of the owners. These objectives could be higher remuneration, prestige, power, status, etc. Further, organisational goal-setting in today's environment is essentially an exercise in bargaining, reconciliation and ordering because of a variety of influences from such groups as worker-unions, government, consumers, suppliers, environment activists, equal-opportunity enthusiasts etc. Indeed, harmonisation of divergent group interests through various forms of side payments in itself becomes an objective for the managers. Hence, managers do not manifest the diktat of a dominant group, rather they represent a collective view or varied interests.

Coordination — the Essence of Management

Many scholars view coordination as a separate function of management. Even Henri Fayol included coordination amongst one of the elements of management. However, since coordination is all pervasive and permeates every function of management, it is better to consider coordination as the overall function or the essence of management. In fact, every managerial function represents an exercise in coordination. Thus, planning, organising, staffing, direction and controlall help the managers to achieve proper coordination. Failure to perform any of the above functions is evidently reflected in poor coordination.

Coordination deals with harmonising the work relations and efforts at all levels for common purpose. It may be described as an exercise in unifying and harmonising individual efforts for the purpose of accomplishing group goals. The whole idea of coordination is to adjust, reconcile and synchronise individual efforts to make group efforts more effective and help achieve some common objective.

Sometimes coordination is confused with cooperation and it is believed that if cooperation exists, coordination will automatically follow. Though cooperation helps to achieve coordination, it is by no means the sole condition for the latter to follow. One can take the example of a football or hockey match as a case in point. A team comprising of best players may find itself hamstrung due to lack of coordinated efforts on the part of its players. If individual efforts are properly coordinated, the group can be more effective than the sum total of its part. But it does not mean that coordination is spontaneous. In fact, differences in understanding, approach, timing interest, or efforts have to be reconciled in any attempt to synchronise individual efforts.

A manager coordinates the work of his subordinates while managing. Following are the useful principles of coordination:

(1) Coordination should be viewed as a responsibility of every manager right from the bottom to the top and every individual should know how his job contributes towards accomplishing objectives of his department and also the dominant goals of the enterprise. Even when a supervisor is able to accomplish the objectives of his department he should be made to realise that his achievement is nothing unless combined with achievements of the other units and contributing to the attainment of higher level objectives of the organisation. Thus, every manager should understand and appreciate hierarchy of objectives or means-ends chain.

(2) Individual efforts are more easily synchronised if coordination is achieved in

the early stages of planning and policy making. Thus, where production and marketing policies are at cross ends, coordination between the two groups of activities will be a serious problem.

(3) Coordination is better achieved through understanding of interpersonal, horizontal rather than vertical relationships of people in the organisation and issuing orders for coordination.

(4) Good communication is another useful principle of co-ordination. As a result of constant change in business environment, plans and policies are frequently revised and compromises and adjustments reached. If required information is not communicated well in time, unifying individual efforts for accomplishment of enterprise goals shall become a difficult task for management.

Development of Management Theory

Management in some form or the other has been of concern to all organised cooperation ever since the dawn of civilisation. Thus, one can witness recognition of organisation and management in the Buddhist order and the Sangha as far back as 530 B.C. Roman Catholic Church and 'military organisations' also offer good examples of early application of management principles. However, systematic study and examination of management is largely the product of the present century and more specifically of the past four decades. Ever since the great contributions of Taylor and Fayol to the management theory, the science of management has been constantly growing at a fast rate.

The Scientific Management Movement

The scientific management movement early in the twentieth century was hailed as a "second industrial revolution". Frederick Taylor is popularly known as the founder of modern scientific management though mention of some of his principles can be found in early writings also.

Taylor began his career as an apprentice in a small machine shop and rose to the level of an engineer. Naturally his writings reflected the practical wisdom and work experience. Taylor's main concern was management at shop level and he was mainly concerned with efficiency of workers and managers at the production level. The major principles and elements of his scientific management may be summarised as follows:

1. Separation of planning and doing, equal division of work and responsibility between labour and management.
2. Replacement of old rule of thumb method of management by scientific method, i.e., scientific determination of each element of a man's job.
3. Scientific selection and training of workers.
4. Absolute cooperation between labour and management in work performance.
5. Determining time standard for each job through stopwatch study of all the essential elements of the job.
6. Introduction of the system of functional foremanship at supervisory level.
7. Differential piece rates of wage payment — workers attaining or exceeding the standard drawing their pay at the higher rate and those falling short of it compensated by lower wage rate.

Since scientific management meant an innovation in the field of management, it generated tremendous opposition even during the life time of Taylor. Public criticism and opinions compelled his appearance before the special Congressional Committee hearings in 1912. The industrial psychologists challenged the assumption of one best *method of job performance*. Although Taylor gave a very lucid explanation of management as a separate and identifiable discipline, his stress of time and motion study and on efficiency at the shop level had the effect of overlooking other general aspects of management, particularly in the U.K. and the U.S.A. In fact, the enthusiasm for Taylorism and scientific management had the unfortunate effect of overshadowing the work of Henri Fayol.

Though Taylor pioneered the scientific management movement, he was by no means the lone contributor. Henry Lawrence Gantt for instance corrected to some extent the difficulties of Taylor's differential piece rate system by devising a new method known as the "task and bonus plan". Similarly, Franck Gilbreth and his wife Lillian Gilbreth, stressed the importance of giving greater attention to minute details of work, and also developed the principles of motion economy intended to eliminate redundant motions and produce a rhythm by scientific development of essential motions.

Henri Fayol

Henri Fayol is popularly known as the father of modern management theory, due to his laying down the theory of general management applicable equally to all kinds of administration and in all fields whether social, political or economic. Henri Fayol started his career as a coal mine engineer in 1860 in a French coal mine and was its chief executive (Managing Director) from 1883 and 1918 during which he brought the enterprise from the verge of bankruptcy to high success. As a manager he came to the conclusion that there was a single administrative science applicable to all types of organisations. In the year 1916, he published his well-known work in French entitled "Administration Industrielle et Generale" (Industrial and General Administration). However, no English translation could be available until the year 1929 and in that year also only a few hundred copies were distributed in U.K.

Fayol divided all activities of industrial enterprises into the following six groups:

1. Technical activities concerning production;
2. Commercial activities of buying and selling;
3. Financial activities intended to seek optimum use of capital;
4. Accounting activities pertaining to final accounts, costs and statistics;
5. Security activities relating to protection of property; and
6. Managerial activities.

The first five are quite well known and as such his work is largely devoted to the description and explanation of the managerial activities. He referred to functions of management as its elements and grouped them around the activities of planning, organising, commanding, coordinating and controlling. Fayol observed that the importance of managerial ability increases as one goes up the echelons of management hierarchy. He also emphasised the need for training in management for which development of management theory is a must. On the basis of his experiences and foresight into the field of management, Fayol suggested the following fourteen principles of management.

1. *Division of Work:* So as to produce more and secure better performance with the same effort.
2. *Authority & Responsibility:* Whenever authority is used responsibility arises, and the two are co-extensive.
3. *Discipline:* To ensure obedience and respect for superiors.
4. *Unity of Command:* An employee shall receive orders from one senior only.
5. *Unity of Direction:* A group of activities with common objectives shall have one head and one plan.
6. *Subordination:* Subordination of individual interest to general interest.
7. *Remuneration:* It should be fair and afford maximum satisfaction to the firm and employees as well.
8. *Centralisation:* Top-management should decide the extent to which authority is to be dispersed in the organisation or retained at higher levels. Centralisation or decentralisation should be viewed as a question of proportion.
9. *Scalar Chain:* It refers to superior-subordinate relations throughout the organisation. It should be short-circuited and not be carried to the extent it proves detrimental to the business.
10. *Order:* There must be a place for everything and each thing must be in its appointed place. Similarly, there must be appointed place for each employee and every employee must be in his appointed place.
11. *Equity:* Management must have the desire for equity and equality of treatment while dealing with people. Equity is the combination of kindliness and justice in a manager.
12. *Stability of Tenure of Personnel:* Management should strive to minimise employee turnover.
13. *Initiative:* It refers to thinking out and executing a plan.
14. *Espirit de Corps:* This principle emphasises the need for teamwork and the importance of effective communication in obtaining it.

Fayol described the above principles as a matter of convenience and did not intend to close the list or make them inflexible.

Contributions of the Behaviouralists, Sociologists and Psychologists

The contribution of behavioural scientists to management principles and practice has been recognised all over the world since the Hawthorne experiments (1928-32) conducted by Elton Mayo and his associates. According to the behaviouralists, the study of management should be concerned with human behaviour in organisations and related matters; organisational effectiveness depends on the quality of relationships among people working in the organisation; good management rests on the ability of managers to develop interpersonal competence among members and to support collaborative efforts at all levels of the organisation.

With its major emphasis on human relations, informal group communication, employee motivation and leadership styles, the behavioural approach to management has drawn attention to a wide range of socio-psychological phenomena like the dynamics of organisational behaviour, group dynamics, organisational

conflict, change and techniques of organisational development.

Psychologists and sociologists have made significant contributions to the behavioural school of thought. Psychologists like A.H. Maslow, McGregor, Leavitt, Chris Argyris, Herzberg and McClelland, and Sociologists like Bakke, Dubin, Katz, Gouldner and Etzioni through their research findings, have laid the foundations of interdisciplinary approaches to the study of organisation and management.

Systems Approach

A significant contribution has been made to the theory and practice of management in recent years by the introduction of the systems approach which prior to World War II was considered applicable and meaningful exclusively to physical sciences. A system is a set of things connected or interdependent so as to form a complex unity, a whole composed of parts in orderly arrangement according to some scheme or plan. The systems approach defines organisation as a complex whole consisting of mutually interdependent parts or sub-systems and interacting with the environment of which it is a part. It views management as a system of inter-relationships involving the processes of decision-making, communication and balancing. The systems theorists' contribution to management thought is based on the recognition of organisations as open, adaptive system subject to all the pressures and conflicts of the environment. Chester I Barnard viewed the executive as a component of a formal organisation, and the latter as a part of entire cooperative system involving physical, biological, social and psychological elements.

Management is an open system. It affects and is in turn affected by the environment in which it operates. Neither objectives nor plans can possibly be set in the vacuum of a closed company system. Markets, government regulations, competitors, technology, and many other elements of an enterprise environment affect plans and objectives and cannot be overlooked. Likewise, no manager can disregard the fact that they are products of, and are influenced by a large cultural environment.

Systems approach to management enable us to see the critical variables and constants and their interaction with one another.

Importance of Management Theory

The need for knowing the theory and techniques of management is important in order to:

(1) Increase efficiency

(2) Crystallize the nature of management

(3) Improve research in management

(4) Attain social goals by way of coordinating the efforts of people so that individual objectives become translated into social attainments.

Contingency Management

Management theory and science do not advocate the "one best way to do things" in the light of every situation. Internal states and processes of organisation are contingent upon external requirements and member needs. Therefore, the actual practice and solution of varied problems differs depending upon the circumstances.

The idea of contingency management is that the internal functioning of the

organisation must be consistent with the demands of organisation task, technology, or external environment and the needs of the members if the organisation is to be effective. Different organisations with different tasks and different competitive environments require different plans. The task of a manager is to apply his knowledge to realities in order to attain desired results.

Responsibilities of Management

All the three levels of management viz., top management, middle management and lower management have obligations towards three social groups: (a) those who have appointed them; (b) those whom they manage; and (c) the general community.

Drucker assigns three jobs to management: Managing a business; managing managers; and managing workers and work. He feels that management must place economic performance above everything else. It is by the economic results which it produces that it can justify its existence and its authority.

While managing, a manager plays many roles. According to Henri Mintzberg, a manager's work role has three phases:

(1) *Interpersonal role:* It relates to his contacts and dealings with other people.

(2) *Informational role:* Because of his interpersonal role, the manager is in a unique position to get information. His contacts with outside world and his leadership position make him a focal point of information. In this role, a manager has to receive and transmit information so that he can develop a thorough understanding of his organisation.

(3) *Decisional role:* There are four decisional roles that a manager has to perform:

   (a) He has to perform the entrepreneur's role by initiating change and taking risk which is involved in introducing change.

   (b) He has to assume the role of a disturbance handler by taking charge whenever the organisation is threatened whether due to external or internal reasons.

   (c) He performs the role of an allocator of resources.

   (d) He performs the negotiator's role in which he deals with those situations where he has to enter into negotiations on behalf of the organisation.

Contribution of Public Administrators

It is interesting to note that public administrators from time to time have exerted their knowledge and experience in developing management science. Several scholars as Dimock, Simon, Friedrick Taylor, etc., have contributed much in specific areas of management, organisation, personnel practices, budgetary controls, planning, etc.

Contribution of Business Executives

Lyndall Urwick, Ralph C. Davis, James D. Mooney, Allan C. Relley and many others have propounded their views on principles of organisation and management. Oliver Sheldon attempted to formulate theory of management as a whole. Another important contribution to the development of management philosophy is that of Henry

Dennison, a businessman. He aimed at studying and analysing the scientific aspects of management, particularly organisation. In essence, Dennison developed concepts of motivation, leadership and teamwork and analysed the structural factors of organisation in their effects on personalities.

A legal framework for the theory of organisation has also been developed by Mooney and Reiley. These authors, undertook to combine the elements of organisation into a sequential pattern of principle, process and effect. They initiated their study with the principle of coordination, concepts of scalar organisation and functionalism. Eventually they arrived at a total of nine principles of organisation. Chester I. Barnard also worked on organisation.

There is no denying the fact that the major contributions to management theory to date have come from persons to whom the practice of management has been a challenging task.

But management thought has developed concurrently in a number of directions and has recently become partially integrated. Teaching as also the practice of management have improved considerably in the recent past.

Administration and Management

It is not infrequent that an attempt is made to distinguish between administration and management. At the same time one can come across cases where the two terms are used inter-changeably. Thus Newman[3] defines administration as "the guidance, leadership and control of the efforts of a group of individuals towards some common goal". There are, on the other hand, scholars like Davis who used the synthetic phrase "administrative management" and distinguished it from "operative management", the former defined in relation to problem solving and decision-making aspects of the organisation, while the latter is concerned with operative aspects of the business. Similarly, Oliver Sheldon draws a distinction between administration and management by defining administration as that function in the industry which is concerned with the determination of policy, the coordination of finance, production, distribution and the establishment of organisation and ultimate control of the executives, whereas management is the process concerned with execution of the policies within limits set by the administration and employment of the organisation for the purpose of accomplishing objectives as laid down by the administration. Still a very interesting analysis of the substance of administration is to be found in the pioneering work of Ordway Tead[4]. He has analysed the administrative process into ten elements largely concerned with establishment of objectives of the organisation, laying down of board policies of structuring and stimulation of the organisation, evaluation of the total outcome and looking ahead. Management, on the other hand, is to strive for attaining the aims and objectives as laid down by administration and within the organisational limits set-forth by it. So viewed, administration is more important at lower levels, as has been depicted below:

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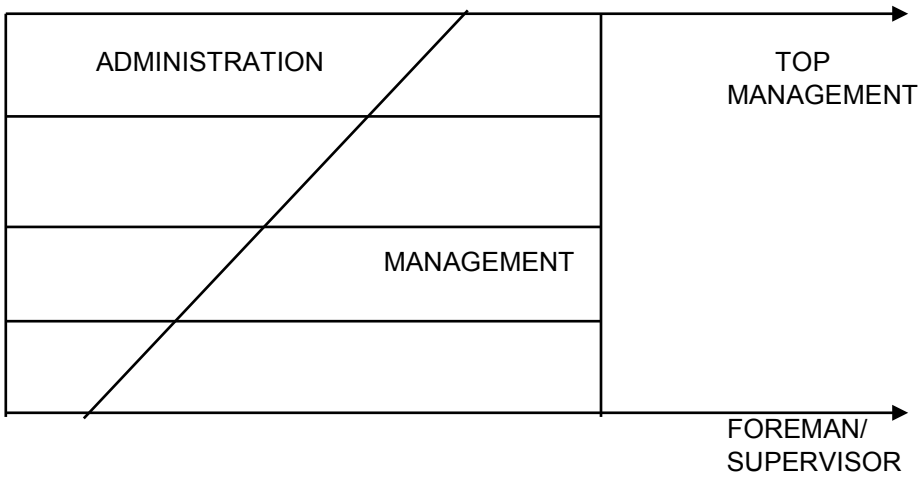
[3] Newman,Summer & Warren – In "The Process of Management".

[4] Ordway Tead – In "The Art of Administration".



Thus, the basic distinction between the two terms is that whereas administration is a process of laying down broad policies and objectives of the organisation, management directs and guides the operations of an organisation towards realising the objectives set-forth by the former. It is also said that administration is a top-level function while management is a lower-level function.

In the perspective of the above views, a clear distinction may be made between administration and management in the following way:

1. Administration is concerned with policy making whereas management with policy implementation.
2. Functions of administration are legislative and largely determinative while that of management are executive and governing.
3. Broadly speaking, administration is concerned with planning and organising, but motivating and controlling functions are involved in management.
4. Board of directors of any company is normally concerned with administration whereas personnel below that level are in charge of management.

There is yet another opinion relating to this distinction. Management is thought of as comprising both the process of planning and policy-making and also their execution. Thus, management includes administrative management (i.e. administration) and operative management.

The conceptual distinction between administration and management hardly serves any purpose. In fact, management process is the same in all enterprises and at all levels in the organisation. Management is as much responsible for planning as is administration. The above point is clearly borne out by the fact that no two separate set of personnel are required to discharge the administrative and managerial functions. It is true that planning is more important and broad at higher levels of organisation, but it is equally true that every manager irrespective of his position or level in the organisation must plan and planning process is essentially the same at all levels. This line of argument acquires further validity if it is kept in mind that administration being implied in all other normal business functions does not constitute

a separate function and never takes place by itself.

Management – Science or Art

Science may be defined as a body of knowledge systematised through application of scientific method in any department of enquiry. Thus, chemistry as a science refers to a systematic body of knowledge accumulated through application of scientific method in this area. Science is systematic in the sense that certain relationships, principles and their limitations have been discovered, tested and established. But it does not mean that the principles and laws so established are immutable for all time to come. Discovery of new knowledge and phenomena can always change any principle irrespective of its nature, standing and application.

Management can then well be described as a science albeit an inexact one if compared with the nature of exact physical sciences. Management has now a theoretical base with a number of principles relating to coordination, organisation, decision-making and so on. It is true that we cannot have the same kind of experimentation in management as is possible in natural sciences. But same is the case with economics, political science, military science and a number of other sciences dealing with the complex structure of group-norms and behaviour. When there is no objection to use the term science for these disciplines, there should not be any controversy about its use to the activity described as management. Moreover, so long as the theory of management improves our understanding, its application in real life, and substitutes rationality for confusion, we should not mind using the term "science and scientific" irrespective of any resistance or even opposition. But it is better to emphasise here that management is still a growing science.

The following features of management as a science are required to be properly understood:

(a) Management is an inexact science because it deals with complex human phenomena about which knowledge is still limited;

(b) Management is still a developing science; and

(c) Management is an inter-disciplinary science.

There should also be not much of dispute over describing *management as an art*. The function of art is to effect change or accomplish goals by deliberate efforts. Practical application of theoretical knowledge is reflected in art. In this sense, management is an art as well. Management principles have been evolved not for the sake of knowledge alone but for their application in concrete situations. In fact, skill in the application of principles to work situations is so important to the job of an executive that some authorities regard management to be essentially an art. Management is an art because of the following attributes:

1. The process of management involves the use of knowhow and skills.
2. The process of management is directed towards the accomplishment of concrete results.
3. It is creative in the sense that it is the function of creating productive situations needed for further improvements.
4. Management is personalised in the sense that every manager has his own approach to problems.

But it does not mean that science and art are mutually exclusive. The fact is that

science is a body of knowledge while art denotes the mode of practical application of knowledge. Evidently both are complementary to each other. Thus, theory and practice of management are mutually helpful, go side by side for the efficient functioning of any organisation.

The most productive art is always based on an understanding of the science underlying it. Actually, managing, like all other arts, makes use of underlying organised knowledge-science-and applies it in the light of realities to gain a desired practical result.

Management as Profession

Growing administrative complexities, emergence of the corporate form of organisation with separation of ownership from management and development of an organised body of systematic knowledge of management are factors of great importance responsible for raising management to the status of a distinct profession. But there are people who still do not agree to management being a profession. To comment on this issue, therefore, one has to be conversant with important features of a profession. A field is normally characterised as profession when the following special features are present in it:

(i) systematic body of knowledge;

(ii) need for learning and proper organisation;

(iii) entry restricted on the basis of examination or education; and

(iv) dominance of service motive.

Except for restricted entry, management qualifies all other tests of a profession. It is now backed by a systematic body of knowledge. A number of management principles have been developed which need proper learning and education. Besides, in a number of countries management institutes, associations and universities are now imparting knowledge relating to management. Moreover, social and moral climate have thrown new challenges to the management. Management of today must be creative rather than adaptive and be conscious of its ethical and social responsibilities to the society. Another important development in the field of management has been that the professional management consultants are growing both in number and quality. But management fails to qualify the test of professionalism relating to restricted entry. Though there is growing awareness in the society to employ properly educated and trained people for managing business enterprises, still self-made managers cannot altogether be eliminated. Thus, similar to the legal or medical profession, management in the strictest sense may fail to satisfy its standing as a profession. But professional overtones are very much present here.

Competent Managerial Personnel

The overwhelming significance of competent managerial personnel to the development of any country should, in no circumstances, go unaccounted. That a small professional elite (of entrepreneurs and executives) can go a long way towards initiating economic growth has also been accepted in the writings of W.W. Rostorw, R.N. Farmer and B.M. Richman.

In fact, the problem of economic development is management oriented. No amount of capital investment and sophisticated technology will succeed in generating national wealth if such wealth-producing resources are badly handled because of

incompetent management. Loan and transfer can, at the best, help to mitigate temporary problems. But if an organisation does not possess a garrison of competent management, how can it maintain a sustained rate of growth and contribute to the country's economic development?[5]

It is needless to mention that in underdeveloped and developing countries, the scarcity of able and competent managers is a severe constraint to the growth and development of industrial and business enterprises and the country at large. Indeed, people are available but those with intellectual potentialities and distinct managerial trait are rare. The search for capable men and women of outstanding managerial ability has never come to an end. Rather the problem is ever increasing with rapid industrial development and has further been accentuated due to fast changing socio-economic-political value of the people, growing complexities in the industrial world and the increased knowledge of management itself. The magnitude of this problem may well be understood from the observation of George R.Terry. He remarked: "The demand for competent administration has always been strong, but for the several decades the executive manhunt has acquired greater and greater emphasis".

Obviously, the pertinent question is, what role do managers play in any organisation? Why so much of importance has been attached to them that it is contended that "business are made or broken in the long run not by markets, or capital, patents or equipment but by men....." (Urwick).

There is no denying the fact that executives and managers play the most vital role in determining the future of any concern in a specific industrial complex and the society at large. On no account should it be forgotten that as victory or defeat in a battle largely depends on the performance of area commanders, likewise fulfillment of the desired mission of any organisation requires effectiveness and efficiency of its higher-up, both individually and collectively. Hence, as a natural corollary, job involvement of these executives can better be highlighted under two broad heads—(i) distinct functions concerning one's specific area, and (ii) general functions related to overall prosperity of the concern.

No matter, whether people belong to sales or purchase, production or publicity, or any other branch of activity of the organisation, it is evident that executives and managers have to deal with very many forces, as well as limitations in the pursuit of a common-purpose. Indeed, they handle a very complex type of job. They owe an overwhelming responsibility to the concern. And naturally to achieve success in their strides, they have to design a course of action from among alternatives of programmes, procedures and methods, verifying whether everything occurs in conformity with a plan adopted, instructions issued and principles established, and make orderly arrangement of individual and group effort to secure unity of action. It is not difficult, therefore, to realise the responsibility of executives and managers of any organisation. From a rational point of view leadership can be looked upon as their essential character, and decision-making their primary job.

In fact, people at the helm of affairs of any organisation share the primary responsibility to achieve its definite mission effectively and in the most efficient manner. Emphatically speaking, any organisation's contribution to society and the country depends on its understanding and knowledge of the situation and

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[5] S. Das, Impact of Social Milieu in the Development of Management Classes (Capital, 1974).

circumstances backed by changing needs and values of the society. As a matter of fact, success on the part of executives essentially calls for capability to utilise material and human resources most effectively.

Concern over Relationship

It must be reckoned in this connection that among the various facts of management, optimal utilisation of human resources is pivotal to all of their responsibilities since the most sensitive factor of production-human factor can neither be purchased nor dictated to get things done by them. Rather it requires a prudent and judicious handling through interpersonal influence exercised in a situation and directed, through the communication process towards the attainment of specific goal or goals, the lack of which may lead to complete failure of organisation. A review of literature also reveals that most management writers acknowledge leadership skill as the determining trait to managerial effectiveness, for their job involves accomplishing goals with and through people in a given situation.

Of course, emphasis on human skills was considered necessary in the past also. But adequate attention was not given to this aspect of managerial trait. Until recently, most of the management experts viewed their job exclusively in terms of jobs and tasks instead of human relationship. But is it at all possible to motivate an individual or group by passing the relationship aspects and the attitudinal and behavioural patterns? However, there is a doubt about the extent to which executive can get their people committed in the absence of mutual relationship and attachment which may be visualised from the way employees:

(i) honour their commitment to objectives;

(ii) maintain conviction for what the organisation stands for; and

(iii) spell out their sense of belongingness to the organisation.

Though there is no yardstick to measure managerial competency in the perspective of human relationship fostered and developed in the organisation, it is not difficult to appraise it from their ability to:

(i) understand the psychology of the individual as well as the group;

(ii) analyse past behaviour and predict future behaviour of the people;

(iii) direct, change and control behaviour of the people according to the need, situation and circumstances;

(iv) promote self-appraisal;

(v) motivate individuals and groups to grow to the fullest extent of their potential.

The above characteristics of proven managerial ability may certainly be identified keeping in view the delicate managerial function to obtain results through individual and group endeavour.

It should be recognised that the human factor is the cockpit of all problems in an organisation on account of its complex nature and fast changing character of socio-economic and political beliefs and values of the society in the perspective of (a) educational, (b) sociological and cultural, (c) political and legal, and (d) economic changes. As a logical consequence, the magnitude and complexity of human problems are also changing. In essence, the relational aspect has received a new

dimension in executive thinking as a result of the overwhelming need for exceptional intellectual skilla distinct quality reflected in the attitudinal and behavioural pattern of managerial personnel.

W.J. Reddin has emphasised the importance of intellectual capacity as a prerequisite to managerial effectiveness and the impact of intellectual skill on the management effectiveness and, as such, advocated that managers must be selected for intellectual capacity, not merely for their knowledge, and the selection should be based on behavioural flexibility because the knowledge which a manager has acquired may often become out of date in a very short span of time.

From the above observation, it may be inferred that Reddin viewed intellectual skill as the one and the most significant factor in managerial effectiveness in view of changing environment. In short, managers, irrespective of the nature of organisation they are associated with or the level at which they are operating should possess intellectual skills to enable them understanding, appraising and responding to emerging patterns of human beliefs and values, attitude and behaviour. No matter what the nature of organisation is, social or economic, managers are supposed to depend heavily on such skills in order to ensure individual as well as organisational effectiveness. Understanding and knowledge of the perspective activate decisions but clearly decisions without understanding are useless, and with poor understanding ineffective.

Of course, we cannot ignore or undermine the need for technical skill on the part of managers. It may be mentioned that while technical skill happens to be an important requirement at the lower level, intellectual skill is the most important and vital at higher levels of the managerial hierarchy of any organisation.

SELF-TEST QUESTIONS

1. Discuss briefly the various functions which constitute the process of management.
2. Identify Fayol's principles of management and describe any four of them.
3. Compare and contrast Taylor's scientific movement with Fayol's general management.
4. Distinguish between administration and management.
5. Is management an art, a science or both? Give reasons for your answer.

Suggested Readings:

(1) Management: A Systems and Contingency Analysis of Management Function — *Koontz & O'Donnell*

(2) Management: Theory and Practice — *Earnest Dale*

(3) Management for Business & Industry — *Claude S. George Jr.*

(4) The Art of Administration — *Ordway Tead*

STUDY IX

PLANNING — POLICIES AND DECISION-MAKING

Nature of Planning

Planning is an all-pervasive and fundamental function of management. All other functions of organising, staffing, directing and controlling must reflect planning function of management. Though more important for higher levels, planning is the function of every manager. It involves deciding in advance what is to be done, where, how and by whom it is to be done. While planning, the manager projects a course of action for the future aimed at achieving desired results for the enterprise as a whole and each department within it. Thus, merely ascertaining the future is not planning till it is followed by making provision for it. Planning is a rational approach to the future.

Planning deals with future and involves forecasting. A manager does not plan about the past though in his planning for future he is also guided by past performance. Since planning relates activities of the enterprise to its future environment, it requires projecting future activities of the organisation. But mere forecasting is not planning. Planning requires assessing the future and providing for it. Planning is forecasting and deciding in advance a course of action to be followed or activities to be pursued in future.

Frederick W. Taylor, the founder of modern scientific management, suggested the scheme of functional foremanship and emphasised the need for separate planning (thinking) from doing on the grounds of specialisation and improved efficiency. Though functional foremanship as suggested by Taylor has found no favour with business executives, in a large number of organisations the planning job is partly organised as a staff function. Absolute separation can hardly be recommended, for it leads to confusion and misunderstanding and adversely affects motivation to work. Moreover, in case of substantial deviations it is difficult to pin-point responsibility on the planning section or the line managers. Thus, an executive has to plan while managing and initiate necessary actions for its successful implementation.

According to George R. Terry — Planning is the selecting and relating of facts and the making and using of assumptions regarding the future in the visualization and formulation of proposed activities believed necessary to achieve desired results. So, planning is a process whereby the relevant facts are collected and analyzed, the assumptions and premises are made regarding the future. In the light of these assumptions and premises, a plan of action believed necessary to achieve the desired results is visualized and formulated. Planning, therefore, essentially means looking ahead and preparing for the future. It is a mental work. One should have reflective thinking, imagination and farsightedness, if one is to succeed well in performing this difficult task.

The essential nature of planning can be highlighted by the following major aspects of planning:

Planning as an Intellectual Process

Planning involves choosing the proper course of action from among alternatives and calls for decision-making which is an intellectual process. Changes in the environment bring opportunities and involve risks as well. It is the task of planners to

take advantage of opportunities and minimise the risks. This calls for mental pre-disposition to think before action. Moreover, planning is not a guess work. It is conscious determination and projecting a course of action for the future and is based on objectives, facts and considered forecasts.

Planning — a Primary Function

Planning is the most basic management function. As a matter of fact, all other functions of management largely depend upon planning. Control, for example, is a necessary corollary of planning and cannot exist without planning. Organisation is also set up with a plan and objectives in mind and people are invariably guided and motivated towards accomplishing enterprise objectives. Planning is, therefore, the primary function of management.

Planning — a Continuous Function of Management

Management is a dynamic process and planning as its function cannot be an exception to it. Since different functions of management overlap and intermesh with each other, the planning process is continuously repeated. Moreover, as plans beget a number of sub-plans and since plans have to be revised in the light of changing environment, planning becomes a continuing necessity for management.

Planning — a Pervasive Function

Planning is a pervasive function. It pervades at all levels and all departments of an organisation. Sometimes, planning is erroneously considered to be the prerogative and responsibility of top management alone. In fact, planning which involves choosing the future course of action from among alternatives is basically the same whether it is at the supervisory level or at higher echelons of management. It must be noted, however, that planning horizons broaden and the implications of plans becomes wider as one goes up the levels in the management hierarchy.

Utility of Planning

Planning substitutes order for chaos and introduces rationality into the decision-making process of management. It provides the framework within which organising, staffing, direction and controlling are undertaken. The importance of planning in any organised enterprise needs no exaggeration. More specifically planning is useful due to its following contributions:

1. *Planning makes personnel conscious of enterprise objectives:* The first stage in any type of planning is the deliberate statement of objectives of each department in the organisation and the enterprise as a whole. It helps personnel to see the enterprise in its entirety and see how their actions may contribute to its ultimate goals. Since objectives represent end points of planning, management should be aware of the future and revise its plans in the light of possible changes so that goals are accomplished more effectively.

2. *Planning leads to economy in operations:* Planning is always done with an eye on economy and efficiency in operations. As an all-pervasive function, planning improves effectiveness of all other functions of management and also helps to secure co- ordinated efforts throughout the organisation. Since it involves choosing, planning facilitates choice of the best method and helps to identify alternatives expected to

produce desired results with minimum of unsought consequences. Planning for repetitive or routine matters reduces the need for thinking over the whole problem once again. And planning for change arms the management to face future contingencies very boldly, confidently and effectively.

3. *Planning precedes control:* Control consists of those activities that are undertaken to force events to conform to plans. Planning is then the necessary prerequisite for control. Management function of control seeks to check the performance against some predetermined standard or projected course of action established through planning process. Though planning affects all other functions of management, the unique feature of control is that it cannot exist without planning.

4. *Planning is a precious managerial instrument to provide for future:* Though forecasting is its essential characteristic, the task of planning does not end merely with assessing the future. Providing for future contingencies is an equally important part of planning. It is through planning process that management is made to look to the future and discover suitable alternative courses of action. To the extent future changes can be correctly predicted planning helps management to have a clear view of the future and chalk out a suitable programme of action. There is no doubt that even the best plans cannot anticipate all the future changes. But it does not mean that planning is a futile exercise which can be dispensed with. As a matter of fact, it is during changing conditions and difficult situations that planning becomes all the more necessary and assumes greater importance. As a rational approach to the future, planning provides for unexpected events and arms the management against undesirable changes.

5. *Planning influences efficacy of other managerial functions:* Planning, organising, staffing, direction and control – all account for and have their due contribution to accomplishment of group's goals. The importance of each to the success of management job cannot be overlooked. However, planning as a primary function goes a long way in improving efficiency of all other functions of management and makes the tasks of managing more effective.

Types of plans

Planning components are usually classified as purposes or mission objectives, policies, procedures, programmes, budgets and strategies.

Purposes or Mission

Organized group activity has, or at least should have, if it is to be meaningful, purpose or mission. In every social system, enterprises have certain basic functions or tasks which are assigned to them by society. The purpose of business is generally the production and distribution of economic goods and services. It is difficult to establish meaningful plans unless an enterprise has a clear and definite notion of its purpose or mission. The mission of a business is the fundamental, unique purpose that sets it apart from other enterprises of its type and identifies the scope of its operations in terms of product and market. The mission is a general enduring statement of the intent of business. (Pearce II & Robinson)

Objectives

The first important task of planning is to lay down objectives or goals. Objectives

represent the end towards which not only planning but all other activities of management are directed. Thus, goals are set for the organisation to accomplish. Similarly, staffing, direction and control aims at reaching common objectives. In fact, managing is more effective than based on properly selected objectives. These objectives should be clearly defined and communicated throughout the organisation.

Plurality of Objectives

Objectives need to be set for the enterprise as a whole and also for each of its departments. To think of a single objective of the enterprise is not a meaningful proposition. On the contrary, it would be more realistic to consider a hierarchy of objectives. There are major objectives for the enterprise as a whole as well as departmental objectives. Similarly, some goals are meant to be achieved in the short run while others are intended for long-term accomplishment. It is necessary to set objectives of performance in every key area of the business. Peter F. Drucker[1] has laid down eight such key areasmarket standing, innovation, productivity, physical and financial resources, profitability, management performance and development, work performance and attitude, and public responsibility. There is also need to decide upon the emphasis to be given to each such area keeping in view the environment within which business operates. Similarly, objectives in different areas should be properly balanced. This is an intellectual task of great responsibility and effort which calls for constant review of enterprise objectives in the light of technological and other changes.

Policies

Policies are guide to thinking in decision-making. Policy lays down the course of action selected to guide and determine present and future decisions. Policy as a general statement of understanding lays down the limits within which decisions are to be made and, thereby, assures consistent and unified performance. For example, if it is the policy of a company to reinvest 50% of its earnings each year, decision relating to appropriation of profit and resorting to external sources of finance shall have to be made within the limits of this policy. Policies can originate at any level in the organisation and a manager should lay down policies within the limits of authority and also within limits set by earlier policies and decisions of his seniors. Generally speaking, policies tend to be more broad and basic as one goes up the echelons of management hierarchy.

Policy may be in the form of written statements or just by way of oral understanding. Thus, where the chief executive has been following the practice of promoting from within the enterprise, it might be interpreted by subordinate as a policy meant for strict compliance. On functional basis, policies may be classified as those pertaining to sales, production, personnel, finance, purchase, etc. Similarly, on the basis of their emergence of formation, policies may be classified as 'Originated' policies, 'Appealed' policies or 'Imposed' policies. If the manager of his own sets out to lay down policies for governing his actions and also those of his subordinates, these are described as originated policies. Originated policy flows down the levels of organisation. It is, however, not infrequent when first line supervisors or managers at lower of middle levels face exceptional problems not covered by existing policies. In such a situation the subordinate manager will appeal to his senior for a decision and

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[1] Peter F.Drucker "The Practice of Management".

policy so emanating is described as appealed policy. Such a policy flows upward. Even customs that have become accepted norms of subordinate behaviour might give rise to appealed policy. Imposed policies, on the other hand, arise because of forces or pressures external to the enterprise which seek a definite compliance. Thus, implementation of agreements with trade unions or trade associations, threat of competition and also compliance with government regulations and laws passed by it require management to formulate policies consistent with these pressures. Imposed policies tend to restrict management direction.

Policies are of great help in delegation of authority by a manager. As a guide to thinking in decision-making, policies sanction in advance the decisions of subordinates so long as these are made within the broad framework of policies established by higher management. Thus, well defined policies help the manager to delegate authority without fear since policies lay down the limits for decisions by subordinates and ensure uniformity in functioning throughout the organisation. However, policies never remain valid for all times to come. Changes in business environment might render some of the policies outmoded. For effective compliance policies should, therefore, be periodically reviewed and necessary changes be introduced in them consistent with accomplishment of group goals. Moreover, as guide to thinking in decision making, policies should be flexible and allow reasonable discretion on the part of subordinates responsible for their implementation. Strictly rigid policies tend to become rules and kill much of subordinates' initiative.

Procedures, Methods and Rules

A plan must also lay down the procedures or ways in which it is to be implemented, specifying the chronological sequence for handling future activities. An enterprise, for example, may have promotion policy based on seniority. To implement this policy, procedures must be established for calculating seniority of employees and granting them actual promotions. It is apparent, therefore, whereas policy is a guide to thinking, procedures are guide to actions. By laying down the specific manner and the order in which activities are to be performed, procedures tend to be less flexible when compared with policy. Since procedures ensure consistency and uniformity in functioning, it is essential that these be laid down after careful analysis and study of the work and also be reviewed periodically to make them consistent with the circumstances.

Procedure consists of a series of steps to be taken. Method, on the other hand, involves a single operation or one particular step and specifies how this step is to be followed.

Rules are different from policies, procedures or methods. As guide to actions, rules are more close to procedure than to policies. Rules signify some kind of regulation, positive or negative and permits no discretion in its application. Thus, when we talk of leave rules, the idea is that leave can be granted and availed of only subject to the regulations contained therein.

Budgets

Budget is single-use plan containing expected results in numerical terms. Budgets may be expressed in time, money, materials or other suitable units capable

of numerical expression. Income and expense budget, for example, projects the expected revenues and expenses for a given period. Since budget is an important control device it is often thought of in connection with controlling alone. However, budget making is primarily a planning process whereas its administration is part of controlling.

Programme

Programme refers to the outline of plans of work to be carried out in proper sequence for the purpose of achieving specific objectives. Thus, a company might embark upon an expansion programme increasing its size by, say, sixty per cent. And to implement this programme, management must lay down certain policies, procedures, methods, rules and other assignments properly related and co-ordinated for its successful implementation. Programme is frequently supported by capital revenue and expense budgets. Thus, programme is a complex structure of policies, procedures, methods, rules, budgets and other assignments.

Programme can originate at any level in the organisation and can be a major programme or a minor one. Basic or major programmes usually call for establishing a number of derivative programmes.

Strategy

Strategy is a term very popular in military science. There it refers to meeting the enemy under conditions advantageous to one's own. A commander, for instance, may allow the enemy to advance upto a certain point and then attack from the back. In the business context a specific meaning attached to a particular policy under prevailing circumstances and in the light of competitor's policies becomes strategy. Strategy is thus an interpretative planning. Anthony defines strategies as resulting from "the process of deciding on objectives of the organization, on changes in these objectives, on the resources used to attain these objectives, and on the policies that are to govern the acquisition, use and disposition of these resources". Chandler defines a strategy as "the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary to carry out these goals".

The purpose of strategies is to determine and communicate, through a system of major objectives and policies, a picture of what kind of enterprise is envisioned. Strategies show a unified direction and imply a deployment of emphasis and resources. They are a useful framework for guiding enterprise thinking and action.

Steps involved in Planning

The techniques of planning may be visualised by analysing the steps involved in major planning. It may be mentioned that planning must follow certain logical steps of techniques to make the same worthy of the purpose. Of course, minor plans are less complex and eventually involve lesser stress and strain in following the steps. But the steps are essentially the same in planning process only with a variations in the degree of complexity involved. Steps in planning may be generalized as follows:

1. *Establishing objectives:* The first and primary step in planning process is the establishment of planning objectives or goals. Definite objectives, in fact, speak categorically about what is to be done, where to place the initial emphasis and the things to be accomplished by the network of policies, procedures, budgets and

programmes, the lack of which would invariably result in either faulty or ineffective planning.

It needs mentioning in this connection that objectives must be understandable and rational to make planning effective. Because the major objective, in all enterprises, needs be translated into derivative objective, accomplishment of enterprise objective needs a concerted endeavour of all the departments.

2. *Premising:* The second step involved in planning process is the establishment of planning premises.

Premises signify planning assumptions or future setting within which planning will take place. The very nature of planning requires that some assumptions be made regarding future happenings. As a natural corollary, it is a prerequisite to determine future settings such as the markets, prices, tax structure, government policy, business cycles, etc., before framing the master plan. Premises, as such may be viewed as an environment of plans in operation.

Indeed, the selection, evaluation and review of planning premises and their use in planning depends upon the skill and experience of the planner. But the difficulty normally faced by the planners are two-fold: (i) selecting what premises to use; and (ii) evaluating the assistance obtained from the use of these premises.

However, it is to be kept in view that all assumptions are not premises. While some assumptions may be considered premises, some represent future expectations from actual plans developed. For example, assumptions pertaining to future business conditions, sales volume, change of government, industrial policy should be considered as premises on which to develop plans. These assumptions or forecasts are a prerequisite to planning. However, it is to be noted that forecast is often the resultant effect of planning. Forecast regarding return on new investment or costs translate a planning programme into future expectations.

At the same time, plans themselves and the forecasts of their future effect often become premises for other plans. The decision of the Tourism Development Corporation of India to start cheaper hotels at the metropolies may be cited as an instance in point. It should be realised, however, that opening of cheaper hotels creates conditions that give rise to premises for many other plans necessarily dependent upon the hotels being built.

It may be noted that premises are not always the same for all the industries, or even units in the same industrial complex. Premises which may be of strategic significance to one industry may not be of equal significance to others due to size of the industry, nature of business and other relevant factors.

Planning premises may be viewed as (i) external and internal, (ii) tangible and intangible, and (iii) controllable, semi-controllable and non-controllable.

Premises internal to the firm are generally comprised of sales forecast, capital investment in plan and equivalent major programmes already laid down and many other factors that shape the nature of planning. External premises may be generalised under three broad heads. The general business environment comprised of socio-economic and politico-technological conditions, the product market and the factor market.

Premises may be tangible as well as intangible. Premises are tangible when it is

possible to quantify those premises in terms of rupees, working hours, mandays, units of production, etc. Intangible premises, on the other hand, cannot be quantified in numerical terms, e.g., goodwill of a company.

Controllable premises are those that are largely decided by company management involving policies and programmes. Whereas premises which, to a considerable extent, may be modulated and controlled by the business enterprises are semi-controllable and those which are absolutely beyond the clutch of business enterprises are non-controllable premises.

However, all these premises need to be attended to minutely to make planning effective.

3. *Determining alternative courses:* The next logical step in planning is to determine and evaluate alternative courses of action. It may be mentioned that there can hardly be any occasion when there are no alternatives. And it is most likely that alternatives properly assessed may prove worthy and meaningful. As a matter of fact, it is imperative that alternative courses of action must be developed before deciding upon the exact plan.

4. *Evaluation of alternatives:* Having sought out the available alternatives along with their strong and weak points, planners are required to evaluate the alternatives giving due weightage to various factors involved, for one alternative may appear to be most profitable involving heavy cash outlay whereas the other less profitable but involve least risk. Likewise, another course of action may be found contributing significantly to the company's long-range objectives although immediate expectations are like to go unfulfilled.

Evidently, evaluation of alternatives is a must to arrive at a decision. Otherwise it would be difficult to choose the best course of action in the perspective of company needs and resources as well as objectives laid down.

5. *Selecting a course of action:* The fifth step in planning is selecting a course of action from among alternatives. In fact, it is the point of decision-making-deciding upon the plan to be adopted for accomplishing the enterprise objectives.

6. *Formulating derivative plans:* To make any planning process complete, the final step is to formulate derivative plans to give effect to and support the basic plan. For example, if Indian Airlines decide to run Jumbo Jets between Delhi and Patna, obviously, a number of derivative plans have to be framed to support the decision, e.g., a staffing plan, operating plans for fuelling, maintenance, stores purchase, etc. In other words, plans do not accomplish themselves. They require to be broken down into supporting plans. Each manager and department of the organisation is to contribute to the accomplishment of the master plan on the basis of the derivative plans.

7. *Numberizing plans by budgeting:* After decisions are made and plans are set, the final step to give them meaning is to numberize them by converting them into budgets. If done well, budgets become a means of adding together the various plans and also important standards against which planning progress can be measured.

Thus it may be seen that the process of planning proceeds along the distinct stages of premising, forecasting and decision-making.

Planning Premises

A host of factors, both internal and external, have to be considered in the planning process. Since it is impracticable for managers to identify and analyse each of these innumerable forces, they should consider only such factors as are materially relevant. But even these strategic factors are full of uncertainties. In order to develop consistent and co-ordinated planning, therefore, the necessity of carefully considered assumptions should not go by default. Such predictions and assumptions about the future are known as planning premises.

Tangible and Intangible Premises

There are premises which can be quantified and expressed in terms of factors like money, time and units of production. These are known as tangible premises. On the other hand, some of the predictions and foundations of planning, though important, defy any quantitative measurement. Public relations, reputation, employee morale and motivation are some of the tangible factors, used as planning premises. In deciding the planning premises management should be very cautious and should not overlook or undermine intangible forces.

Internal and External Premises

Factors like capital, personnel, machines and technology which are within the enterprise, furnish the basis for internal premises. Sales forecasts very often become basic internal premises. External premises, on the other hand, are predictions of factors external to the enterprise. Important external premises include:

(i) Changes in technology; (ii) Government policies; (iii) Population trends; (iv) Product market and changes in the nature of competition; and (vi) Changes in social norms and attitude.

The Planning Period

Plan can be made either for long range or intermediate range, or short range. But there should be some logic in selecting the right time range for company planning. A company should not plan for a longer period than is economically justifiable, yet it is risky to plan for a shorter period. The answer as to the right planning period seems to lie in the “commitment principle”, that logical planning encompasses a period of time in the future necessary to foresee, through a series of actions, the fulfillment of commitments involved in a decision.

What the commitment principle implies is that long range planning is not really for future decisions but rather planning for the future impact of today’s decisions. In other words, a decision is a commitment, normally of funds, direction of action, or reputation. And decisions lie at the core of planning.

The planning period will be longer or shorter depending upon the extent to which flexibility is desired to be built into the plan. The short range tends to be selected to conform to quarters or a year because of the practical need for making plans co-extensive with accounting periods. The arbitrary selection of five years or so for the long range is often based on the belief that the degree of uncertainty over longer periods makes planning of questionable value.

Often short-range plans are made without reference to long-range plans. This is a serious error. No short-run plan should be made unless it contributes to the achievement of the relevant long range plan. Sometimes the short range decisions, which are taken on immediate situation, not only fail to contribute to a long- range

plan but actually impede or require changes in the long-range plan.

The commitment principle must be considered in the light of flexibility principle of planning. This principle applies to the building into plans an ability to change direction. The more the flexibility built into the plans, the lesser would be the danger of losses to be incurred by unexpected events.

The more planning decisions commited for the future, the more important it is that a manager periodically checks on events and expectations and redraw plans as necessary to maintain a course towards a desired goal. This is called the “principle of navigational change”. This principle applies to flexibility in the planning process.

Forecasting

Forecasting may be defined as analysis and interpretation of the future conditions in relation to operations of the enterprise. It involves looking ahead and projecting the future course of events. Forecasts may be comprehensive or limited in their scope. Managers at different levels might themselves be responsible for making forecasts, or the management may employ economists and statisticians as staff experts for making forecasts. In the latter case forecasting experts are usually associated with top management. Since forecasts involve some amount of guess work and are always subject to a degree of error it is essential that business executives bring to bear upon these forecasts their experience and clairvoyance.

Steps in Forecasting

Though it is difficult to lay down common elements of forecasting workable in different situations and acceptable to all, the following steps provide general guidelines:

(1) *Identifying and developing the structure:* Factors affecting future events are so complex and innumerable that it is neither feasible nor desirable to study and discover all of them. The manager and forecaster should, therefore, identify the strategic factors that materially bear upon the forecasts in hand. It calls for analysing the internal and external factors and discovering relations between them. Knowing the trend for each of them is of great help in forecasting.

(2) *Forecasting future course of business:* Having prepared the ground and structure on which to base different estimates, the next step is to make rational forecasts. Those responsible for forecasting make use of statistical and other techniques while projecting future business. The experience, clairvoyance and participation of management are important determinants of the quality of forecasts.

(3) *Analysis of deviations:* The next important step in forecasting is to observe the results and analyse major differences. Major deviation from predictions should be thoroughly analysed and reasons established. It helps to improve the quality of later forecasts.

(4) *Improving the existing forecasting procedure:* Skill in forecasting is largely gained through experience and practice. Hence, it is desirable that one should always think of improving and refining the existing procedure of forecasting. Guess-work should gradually be reduced and substituted by rational judgement and systematic analysis.

Advantages of Forecasting

It is the very basis of planning. Plan is the synthesis of the various forecastsannual, short-term, long-term, etc. Forecasting enables the management to arrive at correct and accurate decision relating to various business matters. Forecasting discloses those areas also where control system is inadequate and where it is more necessary. It facilitates management for using proper control techniques. As forecasting is done by a team, it facilitates team spirit in the organisation which helps planning and coordination.

Forecasting plays a very important role in planning. Fayol referred to planning as synthesis of various forecastsannual, long-term, short-term, special, etc. A large number of planning premises are based on or merged with different forecasts. Moreover, forecasting ensures that all resources shall be fairly used and that future prudently assessed and provided for. This helps management to be prepared for possible surprises. It is also found that if forecasting is based on participation of different levels, it helps the personnel to unify and co-ordinate their plans effectively.

Forecasts are based on postulations and assumptions and, as such, are subject to some amount of guess-work. Possibility of error cannot be completely eliminated from forecasts. Management should, therefore, be aware of different forecasts. But limitations implied in forecasting are not so serious as to discourage business executives from attempting future projections. The fact is that management cannot do without them though there is an ever-present need for critical examination and review of different forecasts.

Forecasting may be needed for future planning but it cannot be confused with later.

Decision-Making

Decision-making signifies actual selection of a course of action from among a number of alternatives. It is so important to the job of managing that management is sometimes described as consisting essentially of the decision-making process. Decision-making permeates planning, organising, controlling and all other functions of management. Because of limitations in time, money etc., management is forced to discover a number of alternatives and choose that alternative which is expected to contribute more with less costs and other unsought consequences to the accomplishment of some goal. Since decision-making involves selection from among alternatives the course of action to be followed, it is better regarded as part of the planning process.

Management has to take decisions on all types of problems and matters. Generally, decisions relating to routine matters are decentralised so that top-management can concentrate on vital and strategic decisions and laying down broad policies. It also adds to efficiency of management if decisions relating to distant future are made in advance. However, it needs to be emphasised that decision-making as a rational process should be based on systematic analysis of all pertinent facts and not guided by institution or hunch.

Decision-Making Conditions

All organisations do not exist in the same type of situation and the situations do not remain the same for all decisions. Though, it is difficult to identify each and every situation and discuss it in this study lesson, we can classify various situations into

three possible conditions. These are: (i) Certainty (ii) Risk (iii) Uncertainty.

(i) *Certainty:* This condition is present if the decision-maker knows exactly what will happen. Thus, he will be able to predict the outcome precisely. For instance, if we are going to put Rs. 1,000 in a fixed deposit for a year at 6 per cent rate of interest, then we will know how much interest (Rs. 60) our money will earn. When a decision is made under certainty, a manager knows exactly what the outcome will be because he knows his resources, time available, and other things.

(ii) *Risk:* The future conditions are not always known in advance. In real life, most managerial decisions are made under risk conditions, that is, some information is available but it is insufficient to answer all questions about the outcome. So a decision-maker has to make probability estimates of these outcomes. How can one assign probability estimates to various courses of action? One has to depend on past experience if the situation is similar. But no two situations are exactly similar in business operations. If probability estimates are assigned to expected outcomes on the basis of past experience, then it is known as objective probability. On the other hand, if the probability estimates are assigned on the basis of what is known as "gut feel" then it is subjective probability. The "gut feel" here refers to how an individual feels about the problem and the course of action to solve that problem and not totally relying on past experience.

There is no rule of thumb approach in assigning probabilities to various courses of action. Some may use quantitative technique such as expected value analysis by which the expected payoff an action can be mathematically determined. Whatever the method used, the attitude of the decision-maker is an essential ingredient when making decisions under conditions of risk. Some decision-makers are risk takers while others are risk averters. A certain amount of risk-taking ability is essential for managerial success.

(iii) *Uncertainty:* Under these conditions, the decision- maker feels that he cannot estimate probabilities for various alternatives or outcomes because he has no way of measuring the likelihood of those alternatives. For instance, if you are planning a trip to Kashmir, have never been there before, and have not heard about the weather in Kashmir during winter, you may be in a predicament as to what clothes to carry and what precautions to take.

Principles of Decision-Making

A manager's effectiveness is related to the quality of his decisions. Decision-making by a manager involves arriving at conclusions and exercising judgement. In all circumstances management decisions should follow a few basic principles which are likely to ensure its soundness.

1. *Principle of definition:* A logical decision can be made only if the real problem is defined with minute attention. Too often time and effect are wasted due to the manager's inability to pin-point what the problem isor the objective. Indeed it would be no exaggeration to suggest that a problem well defined is half solved.
2. *Principle of evidence:* Decisions should not be taken hastily. It must be based on evidence, meaning that adequate facts must be there to back the judgement. When the facts underlying a problem are collected and care is taken to analyse the situation, the basic work in decision-making is done.

3. *Principle of identity:* From a different perspective the same object usually appears to be different to different people. Not only that, the relative importance of the same fact differs from year to year.

It is, therefore, urged that the decision-maker should take into account different viewpoints and determine the relative significance of the time period during which the event happened. In the case of decisions involving two or more persons, it is required that views of each such person should be taken into consideration weighted carefully and checked with other sources before a decision is taken.

Steps in Decision-Making

A manager is responsible for making decisions on matters falling within the scope of his authority and normally decisions which can be taken at a given level should not be referred to higher levels. A manager should use his skill and intelligence while deciding on a problem because quality of decisions made by him indicates the extent of responsibility discharged. Steps in decision-making are as follows:

1. Identifying and diagnosing the real problem

Understanding the situation that sets the stage for decision-making by a manager is an important element in decision-making. Predetermined objectives, past acts and decisions and environmental considerations provide the structure for current decisions. Once this structure is laid, the manager can proceed to identify and determine the real problem.

Diagnosing the real problem implies knowing the gap between what exists and what is expected to happen, identifying the reasons for the gap, and understanding the problem in relation to higher objectives of the organisation. However, sometimes symptoms are mistaken for real problem. Defining a problem is thus not an easy task. Very often it consumes a lot of time which is worth spending.

2. Discovery of alternatives

The next step is to search for available alternatives and assess their probable consequences. But the number of forces reacting upon a given situation is so large and varied that management would be wise to follow the principle of the limiting factor. That is, management should limit itself to the discovery of those key factors which are critical or strategic to the decision involved. Thus, while planning for expansion of the enterprise, availability of finance or of trained staff during a short span of time might be the limiting factors.

Discovery of the limiting factors is so important to the process of decision-making that sometimes it is described as search for the strategic factors. But search for the limiting factor or factors is by no means easy. However, in any attempt to discover the strategic factors management should not lose sight of higher objectives of the enterprise and analyse the limiting factors in terms of their contribution to the accomplishment of organisational objectives.

3. Analysis and evaluation of available alternatives

Once the alternatives are discovered, the next stage is to analyse and compare their relative importance. This calls for listing of the pros and cons of different alternatives in relation to each other. Management should consider the element of risk involved in each of them and also the resources available for their

implementation. Executives should weigh each of them from the viewpoint of accomplishment of some common goals and in relation to effort involved and results expected.

Both tangible and intangible factors should be considered while evaluating different alternatives. Tangible factors like profits, time, money, and rate of return on capital investment can be expressed numerically. Such factors are usually evaluated and compared by projecting their effects on income, expense and cost structure of the enterprise. Since factors are analysed for the future, their evaluation is based on forecasts and estimates. It is, therefore, better if the analyst discovers the extent to which different estimates can be relied upon.

Management can afford to overlook intangible factors in situations where their effect on the course of action is negligible. However, facts like public relations, reputation, employee morale and personnel relations prove significant and cannot be ignored is spite of difficulties to express them numerically. The analysis should, therefore, identify the relevant intangible factors and ascertain their relative importance to arrive at a judicious decision.

Sometimes, the manager is faced with a situation where two or more alternatives appear equally good or bad. In that case actual difference will be the deciding factor. Similarly, where none of the alternatives under consideration is expected to produce desired results the manager will do well to decide in favour of no action or else trace undiscovered alternatives.

The evaluation of alternatives may utilize the techniques of marginal analysis, wherein the additional revenues from additional costs are compared. The real usefulness of marginal approach to evaluation is that it accentuates the variables in a situation and de-emphasizes averages and constants.

Alternatives can also be evaluated on the basis of cost effectiveness. It is a technique for choosing from among alternatives to identify a preferred choice when objectives are far less specific than those expressed by clear quantities. Cost effectiveness criteria can be made more systematic through the use of models and other techniques.

4. Selection of alternative to be followed

Defining the problem, identifying the alternatives and their analysis and evaluation set the stage for the manager to determine the best solution. In this matter a manager is frequently guided by his past experience. If the present problem is similar to one faced in the past, the manager may have a tendency to decide on that basis. Past experience is useful guide for decisions in the present. But it should not be followed blindly. Changes in the circumstances and underlying assumptions of decisions in the past should be carefully examined before deciding a problem on the basis of experience.

(i) *Selection on the basis of experiments*

It is sometimes argued that managers should draw conclusions on the basis of experiments. Say, a plan relating to personnel matters may be tried in a branch office before extending it to other places. Experimentation as the basis for final decision has the advantage of incorporating intangible factors and also the environmental changes. But it has the limitation of being the

most expensive of the techniques and as such is generally recommended for use only when all other bases have been tried.

(ii) *Research as the basis for decision*

Another useful basis for decision is the application of scientific method to planning and decision-making. Application of research techniques helps the manager to visualise the problem and casual relationships between different variables in mathematical terms. In the recent past, extensive research has been carried out in the field of management with a view to developing a sound theory and practices of decision-making. A number of research approaches and techniques have been developed in economics, accounting, mathematics and other disciplines which have greatly contributed to this trend. Break-even analysis, marginal contribution analysis, forecasting, capital budgeting, standard costing, sensitivity analysis, operations research and the like, provide examples of research techniques currently in use in the field of decision-making.

5. Communication of decision and its acceptance by the organisation

Once decision is made it needs to be implemented. This calls for laying down derivative plans and their communication to all those responsible for initiating actions on them. It will be better if the manager takes into account beliefs, attitudes and prejudices of people in the organisation and is also aware of his own contribution to implementation of the decision. It is further required that subordinates are encouraged to participate in decision-making process so that they feel committed and morally bound to support the decision. At the same time management should establish effective control so that major deviation can be observed, analysed and incorporated in future decisions.

Hierarchy of Decisions

All decisions at all the time are not of equal importance. The manager should, therefore, determine the importance of each decision in terms of its commitment, scope and risk involved. In essence, the manager would be able to pass on less important decisions to be made at lower echelons of management in the organisation and this will help him to determine the kind of analysis and research needed in arriving at a conclusion keeping in view its importance. Thus, less important decisions can be based on simple analysis whereas important decisions must be made after a thorough analysis of all the pertinent factors.

Decision-making by Groups

Decision-making by groups is not a rare thing to observe in business operations. Board meetings, committees, staff-meetings, conferences, provide examples of decisions-making by groups. Thus, directors at the top of an organisation make decisions in their board meetings. Similarly, departmental managers or executives solve a number of problems jointly.

In what type of problems, at what level, and how, decision-making by group may be used in the organisation is a policy matter and rests with higher ups. But wherever it is resorted to, the appointing authority should lay down in explicit terms the scope and exact functions expected of the group. If properly handled, decision-making by groups or committees offers the following advantages:

(i) It improves quality of the decision since different viewpoints and opinions are reflected in it.

(ii) Co-ordination of departmental activities through meetings of their respective heads become easier.

(iii) Group decision-making provides opportunity for participation by individual representing different interests and thus improve their morale and motivate them for whole-hearted co-operation in carrying out the decisions.

(iv) It provides opportunity for training of employees and their development as future decision-makers.

Of course, group decision-making is not free from limitations. The important weaknesses may be enumerated as follows:

(i) It is costly as well as a time-consuming affair and, as such, cannot be recommended particularly in situations where decisions must be made promptly.

(ii) More often differences in opinion and compromises lead to indecision.

(iii) It is also observed that group decisions help members evade their individual responsibilities.

(iv) If an individual member of the group is able to dominate discussion in the meetings, decisions so made does not represent synthesis of viewpoints of different interests.

Evaluating the Decision's Importance

How important a decision is to an organization can be assessed on the basis of the appraisal of the following factors:

(1) *Size or length of commitment:* If a decision commits the enterprise to heavy expenditure of funds, or to an important personnel programme, or if the commitment can be fulfilled only over a long period, it should be subjected to suitable attention at an upper level of management.

(2) *Flexibility of plans:* Decisions involving inflexible courses of action must carry a priority over those easily changed.

(3) *Certainty of goals and premises:* If goals and premises are fairly certain, a decision resting on them tends to be less difficult than where they are highly uncertain.

(4) *Quantifiability of variables:* Where the goals inputs, parameters, and variables can be accurately quantified, the importance of the decision, other things remaining the same, tends to be less than where the inputs are difficult to quantify.

Limitations of Planning

Planning is an all-pervasive and a primary function of management. No manager, irrespective of the position in the organisation can do without it. However, planning subject to certain limitations and a proper understanding of them will go a long way in improving efficiency of planning.

1. *Planning premises may not be fully reliable:* Planning premises provide the basis and framework for predictions. Since the future cannot be predicted with absolute accuracy, premising is always subject to a margin of error and guess-work which are reflected in various plans based on them. Difficulty of accurate premising

then becomes the first planning limitation.

2. *Rapidity of change sets another limit to planning:* Business enterprises operate in a changing environment, though the extent and impact of such changes may differ from industry to industry and among firms in the same industry. Planning is relatively simple and easy for a concern operating under stable conditions. Most of the public utilities enjoy such an advantage. On the other hand, industries and units working under dynamic conditions and confronting rapid changes face new problems and complications on account of instability. It makes their planning job extremely difficult.

3. *Availability of time and cost involved in planning also lay down limits to planning:* During a crisis or any other emergency, decisions have to be made without planning in advance whether the manager is ready for it or not. Such decisions are taken in the event of non-availability of time for detailed analysis and research.

Besides, planning is not without cost. Greater the details in planning, more will be the cost. Similarly, cost of planning will go up if plans are drawn for longer periods. While finalising details of analysis the manager should remember that the benefits expected to be derived from planning should be more than the cost involved. But application of this rule is by no means an easy task. This is because ascertainment of the benefits and cost of planning is a difficult exercise.

4. *Philosophy of management and personnel can be a very serious limitation of planning:* Old concepts, beliefs and traditions are often so deeply embedded in the minds of employees that plans which are not consistent with their philosophy may be extremely difficult to implement. Thus, where management is traditionally committed to high quality and high costs, it may not be inclined to carry out a plan to produce cheaper goods even though justified by results expected. Psychologically, people are resistant to changes and as such new ideas have to be sold and people convinced of the value of the change.

5. *Procedural and policy rigidities also come in the way of planning:* Procedures, rules and policies once established are difficult to change. Planning, on the other hand, may call for a change in the existing procedures and policies. Where such internal inflexibilities dominate the enterprise, management tends to become bureaucratic and rule-centered. In such a case employees lose much of their initiative and effective change through planning becomes a challenging job.

6. *Capital invested in the firm is a very powerful internal constraint on planning:* Changes in the environment may require overlooking consideration of capital already sunk in the business in the form of, say, capital equipment or employee training. Managers, on the other hand, develop a strong tendency to feel so much committed to recovery of capital sunk as a result of some earlier decision that future planning is constrained and limited to its recovery, and very often capital so invested itself becomes a planning premise.

7. *External constraints also set limit to planning:* There are those external limitations of planning over which management has very little or no control at all. Personnel policies and decisions might be limited by considerations of labour union pressures particularly when union is organised on national basis, and also by directives, rules and legal provisions as laid down by Government from time to time. Similarly, Government policies, tax laws, competition and technological changes, etc., act as sufficient limits to planning in varying degrees for different problems at different

times.

In the actual planning process manager may face many more difficulties. But these limitations of planning should not demoralise management in any way from attempting to plan. If managing becomes more effective through planning, the manager has no alternative but to plan. When planning is so useful it will be better if it is done systematically keeping in view the possible limitations of planning.

SELF-TEST QUESTIONS

1. Define planning. State the chief characteristics of planning.
2. Define the term "Planning premises". What are the various kinds of planning premises? What is the role of premises in making planning effective?
3. How is forecasting related to planning? Briefly discuss the different steps involved in forecasting.
4. "Procedures are guides to action". Comment.
5. "Decision-making involves choosing from among alternative solutions". Comment.
6. Discuss the various steps involved in decision-making.
7. Write notes on the following:
   (a) Policies.
   (b) Budgets.
   (c) Programme.

Suggested Readings:

(1) Principles of Management — *George R. Terry*
(2) Essentials of Management — *Joseph L. Massie*
(3) A Concepts of Organisation — *Paul E. Togerson*
(4) Principles of Management — *Peter F. Drucker*
(5) Management: A Functional Approach — *Joseph M. Putti*

STUDY X

ORGANISATION (I)

Organisation as a Process and Structure

Organisation in a formal sense refers to a collectivity of persons engaged in pursuing specified objectives. The behavioural scientists and the sociologists view organisation as comprising human relationships in group activity. It is referred to as the social system encompassing all formal relations. Another way of looking at organisation is to consider it as an essential function of management. In operational sense, organisation can be considered as consisting of divisions of work among people and coordination of their activities towards some common objectives. The important steps in organising are:

1. Enumeration and grouping of activities of the enterprise consistent with its objectives.
2. Assignment of grouped activities to different executives.
3. Delegation of authority and placing of responsibility for carrying out the assigned duties.
4. Making provision for effective coordination between them and establishment of definite lines of supervision.

The idea of structures in an organisation is also a fundamental one. It is characterised by activity-authority relationship in an enterprise. Organisation as a structure is a consciously conceived and created pattern of tasks, roles and relationships among individual members of a group towards the accomplishment of its objectives. This pattern or network may be exhibited by way of organisation chart.

Understanding the organisation as a structure of formal authority relations is, however, the traditional view of analysts. Organisation process is much more complex than what is traditionally assumed. Theories have been developed to describe organisation as a system of human relationships, social system, or the total system comprising a number of interacting sub-systems. It is, therefore, essential that while designing the structure the organiser should take into account the mechanistic and also the humanistic points of view.

The organisation structure is not an end by itself, it is rather a means to an end. It is created to achieve certain goals, and organising in turn is done to accomplish those objectives. Peter F. Drucker also views organisation as a means to the end of business performance and results. Organisation should be designed so as to help accomplish business objectives. He also suggests four ways of discovering the kind of structure to attain objectives:

(i) Activity analysis;

(ii) Contribution analysis;

(iii) Decision analysis; and

(iv) Relation analysis.

1. Activity analysis

Organisation design starts with the identification of key activities. The important questions are In what area is excellence required to obtain the company's objectives? In what areas the lack of performance endanger the results, if not the survival of the enterprise? In what areas do we have major vulnerability? What are the values that are truly important to us in the company?

2. Contribution analysis

Activities can be grouped into four categories on the basis of the kind of contribution they make — result producing activities, support activities, hygiene and house-keeping activities, and top management activities.

Result producing activities directly bring in revenues, while the support activities generate outputs which contribute to results. The hygiene activities contribute nothing directly to the results of the business but their malfunction can, however, damage the business.

The classification of activities is important so that the activities that differ in contribution be treated differently. Key activities should never be subordinated to non key activities. Support activities should never be mixed with revenue producing and result — contributing activities.

3. Decision analysis

To place authority and responsibility for various kinds of decisions, they must be classified according to kind and character. There are four basic characteristics which determine the nature of any business decision:

(a) Degree of futurity in the decision.

(b) Impact of decision on other functions, areas or business as a whole.

(c) The number of qualitative factors that enter into it: basic principles of conduct, ethical values, social and political beliefs, etc.

(d) Whether they are periodically recurrent or rare.

A decision should always be made at the lowest possible level and as close to the scene of action as possible.

4. Relation analysis

It tells us where a specific component belongs. Smallest possible number of relationships should be imposed on an activity. But, the activity should be so placed that the crucial relations should be easy, accessible and central to the unit. The rule is to keep relationships to a minimum but make each count.

Purpose and Cause of Organising

It needs to be emphasized that structure is a means, not an end in itself. As such not only should it facilitate achievement of enterprise objectives through orderly organised group effort but also it should do the same with the least cost in terms of time, money, effort and pain. Thus, strictly speaking, the structure does not have objectives of its own, rather it is a manifestation of enterprise objectives in terms of those attributable to the specific tasks, roles and relationships.

The basic cause of organization structure lies in the limitations of span of management. If there were no such limitations, one could have an organized enterprise with only one manager. The number of subordinates a manager can

effectively manage may be a few or many depending upon one's ability, the job, and basic factors that influence time demands.

Dynamic Organisation Structure

Organisation structure should not be static. An enterprise operates under a highly dynamic environment where technology, social, political and economic setting in which it operates, and the people managing the organisation are continually in a flux. This calls for adapting the organisation structure to changing conditions so that it can survive and grow. A change in economic function generally calls for redesigning the organisation structure. Intense competition may require profit decentralisation and provision of better service to the people. Economic considerations may favour vertical disintegration of particular process. Such changes in economic functions influence the organisation structure largely through changing the jobs. Similarly, capacities of the people working in the organisation grow, change and diminish. Accommodating these changes in the organisation require that the structure should be partly modified so as to adjust it to changes in the attitudes, ambitions and abilities of the people.

Organisation as Part of the Total Management Task

Organisation is closely related to other phases of management. This becomes more obvious when we consider changes in the organisation structure and project effects of such changes on other tasks of management. In fact, changes in organisation structure must be matched by suitable changes in planning, staffing and controlling phases of management. It becomes further clear when it is remembered that organisation comes to life only in association with other tasks of management. Thus, organisation should always be viewed as part of the total management task.

Traditional Principles of Organisation Structure

Traditional organisation theorists developed certain principles of organisation as guide to thinking in organising. These principles are intended for universal application to all enterprises and cooperative efforts in different fields. The most important of these principles can be listed under the following heads:

1. Division of Labour or Specialisation

The classicists viewed specialisation as the basis of efficiency. A group of individuals can secure better results by having division of work. F.W. Taylor applied this principle at the operation level and displayed how efficiency could be increased by breaking down jobs into single repetitive tasks performed on specialised tools. At higher levels, however, grouping jobs into manageable units and their co-ordination can pose serious problems.

The principle of specialisation has been challenged by the behaviouralists and others. Fatigue, monotony and boredom are inevitably the outcome of division of labour. While specialisation causes great functional interdependency among operatives, it also depersonalises their activities so that individuals find little meaning in the work. Moreover, functional interdependency among work activities causes strains and tensions. Specialisation leads to a different type of problems at the executive level. It tends to segment the organisation into enclaves of authority and influence. Often executives come to regard these domains as their own empires which receive their attention to the neglect of the organisational interest.

2. Consideration of objectives

Organisation offers the structure that enables us to accomplish goals. Objectives are helpful in determining the activities and the structure itself. Once objectives are clearly defined, the organiser can conveniently proceed to group activities, delegate authority to individuals to whom activities have been assigned and coordinate their efforts for better results. Since objectives have a direct bearing upon the organisation structure, one should take due cognizance of time, and develop and design the structure so as to facilitate accomplishment of objectives. The assumption underlying this principle is that the work norms and means adopted by the organisation are acceptable to the individuals and groups. However, in reality, there is often a divergence between individual needs and organisational goals.

3. The Scalar Principle

The vertical dimension of organisation structure consists of levels of authority arranged in a hierarchy from the chief executive at the top to the first-line supervisor at the bottom. Existence of these levels is always the characteristic of organised and coordinated group efforts. Consider the members of a group formed spontaneously to help push a car out of mud. Someone sees it is desirable to call signals and gives the word at which every one exerts his effort in unison with the others. Clearly a leader has emerged producing a two-level group consisting of the leader at the top and the pushers as followers. In a complex business organisation, the number of levels may be substantially large.

The scalar principle holds that organisation consists of two or more levels of authority. The basic idea of this scale is that of grading or distributing a characteristic over a series of demarcated units. In organisations, the levels represent gradations of distributed authority. Each successively lower level down the management hierarchy represents a decreasing amount of authority.

4. The Principle of Departmentation

Logical grouping of related jobs and functions is quite natural in developing the organisation structure. Departmentation requires analysing everything that has to be done and determining the grouping in which it can be placed without violating the principle of homogeneity. Thus, financial aspects of the business can well be placed in one section. Departmentation is desirable because individuals vary considerably in the range of activities which their abilities will permit them to perform effectively. Another advantage is that it focuses executive skills on logical and interrelated problems and provides a basis for top management to coordinate and control the efforts of the departments. Departmentation breaks the work into manageable units. Gulick viewed four possible bases for departmentation – purpose, process, product and place. Choice of basis is a recurring question and changes as the organisation grows, develops or employs a new technology.

5. The Principle of Unity of Command

A business organisation must have a single head in whom all authority and responsibility is concentrated, but this has to be blended with the efforts of the organised people below. The single leader is the ultimate source of authority by which conflicts are minimised. Unity of effort, consistency of direction, high morale and effectiveness of coordination depend upon one executive as the locus of ultimate responsibility. To subject the person to the authority of more than one immediate superior tends to divide his loyalty and confuse his action.

6. The Principle of Span of Control

The idea of span of control is related to the horizontal dimension of an organisation structure. Span of control (also referred to as the span of supervision or span of management) refers to the number of subordinates reporting directly to the executive. The principle holds that larger the number of subordinates reporting directly to the executive, the more difficult it tends to be for him to supervise and coordinate them effectively.

It is to be admitted that there is a limit to the number of subordinates a manager can effectively supervise, but what should be that limit is yet an open question. In addition to the numbers, two other variables are involved in this principle. The first is the capacity of the higher executive to do his work efficiently, and second is the capacity of the executives to supervise. Since these variables differ considerably from individual to individual, it is hardly justified to lay down any fixed number of subordinates to be supervised by the manager.

7. The Principle of Flexibility

Organisation is created to accomplish certain goals. Both the environment and the individuals comprising the organisation are constantly in flux. To cope with these changes and yet reach its objectives, an organisation must be designed with sufficient amount of flexibility. A flexible organisation is able to withstand pressures, but gives way to the demand for genuine change without fundamentally altering the basic functions of the various segments of the structure.

8. The Principle of Balance

This principle implies that each area and function of an enterprise should operate with equal effectiveness in making its allotted contribution to the total purpose. Problems of balance arise from the tendency to sub-divide the work into small units. If sub-division is carried too far, the problem of timing, coordination and integrating the work sequences becomes very complex. The idea of balance applies to organisation structures as well as to functions and processes. The growth of business, whether sudden or gradual produces pressures which upset organisational balance. And therefore, changes in organisation structure should be made after giving full consideration to balance, and by avoiding over-reliance upon any single type of structure. Horizontal and vertical dimensions should be kept in balanced relationship to one another.

9. The Exception Principle

The next very useful fundamental of organisation structure is the *exception principle*. This principle implies that only problems involving unusual matters should be referred upward and decided by higher level executives; and that routine problems should be passed on to lower levels and resolved there itself. It implies devising a method of control so that only exceptional results are flagged for management attention. This principle is based on the assumption that management at higher echelons of organisation structure have limited time and capacity. And they should devote a larger part of their time and abilities to important matters of planning and policy making.

Exception principle is also the principle underlying delegation of authority. If a subordinate does not make decision on problem falling within the limits of his

authority and consumes disproportionate time than his senior, delegation shall prove ineffectual. The principle of exception is thus of great practical utility and applies at all levels in the organisation structure. By forcing a distinction between programmed decisions and the non-programmed decisions, the exception principle helps the manager to concentrate on un-programmed decisions involving new and unstructured elements.

10. Principle of Decentralisation

This principle is of great significance in the organisation, specially to large enterprises. There is said to exist decentralisation in an organisation if decision-making authority is pushed down to its lower levels and near the source of information and action as possible. It is also frequently used to indicate either geographical dispersal or delegation. However, F. Drucker's views on decentralisation are quite penetrating and interesting. He terms geographical dispersal or delegation as mere "administrative reforms" intended to relieve pressure on top management. Rather, decentralisation provides a new ordering principle in which both centre and parts discharge real top management functions. He calls this as the principle of 'federal decentralisation' which is based on organisation of activities into separate product business with separate markets and production and profit goals for each. These views are in the idea of profit centres as organisational units consonance with.

11. Principle of Simplicity

The idea of simplicity in organisational structure may at first appear facetious in view of the large size and complex nature of many of our business organisations. Nevertheless, simplicity is an objective of organisational planning.

Simplicity is an appealing objective because it implies economy of efforts. This principle in brief states: "It is desirable to consider simplicity of structure in developing an organisation, aiming for as clear-cut structure as will permit doing the necessary work efficiently".

As noted earlier, organisation structure is a means, not an end in itself. Thus, the notion of simplicity is identifiable with the convenience with which people – perhaps many having face-to-face personal contacts are able to combine into performing groups.

12. Combination of Line and Staff Functions

Organisation structures are usually of line, staff and functional types. Line structure is part of every organisation. The staff and functional types are modifications of the line structure. Staff and functional structures seldom exist apart from a combination with line structure.

Line structure consists of vertical relationships with power to command and execute. Staff functions are auxiliary to the line functions and are advisory in nature. On the basis of distinction like this, it is argued that line and staff functions should not be combined in one individual or department where separation of the functions is possible. The reason is that these are basic authority relations, combination of which will result in confusion.

The above list of principles of organisation structure is not intended to be complex, nor are these principles meant for application as immutable laws. These principles should be used as mere fundamentals or guides to actions while designing the organisation structure.

Developing an Organisation Structure

Designing a new organisation structure or reorganising an existing one calls for careful consideration of current practices and principles of organisation. There are, however, no such rules the application of which will lead to the best organisation structure in every situation. But the following steps can be of great help in designing a suitable structure which will aid in achieving enterprise objectives:

(i) *Clear Definition of Objectives:* The first step in developing an organisation structure is to lay down its objectives in very clear terms. This will help determine the type, stability and basic characteristics of the organisation. In fact, organisation activities are detailed in terms of objectives to be achieved.

(ii) *Identifying the Activities and Grouping them into Convenient Classes:* The next important step in developing an organisation is enumeration of activities necessary to achieve the objectives, their grouping in a systematic manner, assignment of such groups of activities to personnel and providing for their coordination. Wherever possible, similar functions should be combined into one position.

(iii) *Determine the Structure:* The first two steps outlined above set the stage for actual determination of the organisation structure. More specifically, the organiser has to decide about the span of supervision, types of organisation, basis of departmentation and the pattern of authority structure.

(iv) *Revise the Structure on the Basis of Assessment of Personnel and other Resources:* The last step in developing a suitable organisation structure is to assess the capacities and abilities of the people available to man the different positions in the organisation along with other resources at the disposal of the enterprise. The ideal organisation should then be adapted to fit the reality of the situation.

Principles of organisation and steps in developing the organisation structure outlined above provide only the general guidelines to be followed. However, each enterprise should be viewed as a separate case and developed accordingly. It is unwise to follow a particular structural form simply because that proved more affective in one instance. Local conditions, business objectives and policies, scale of operation, nature of work, and above all character and abilities of personnel available are important factors to be considered while developing an organisation structure.

Theories of Organisation

There exist a number of theories of organisation and organisational behaviour. Many well-known writers have given their own views on organisation. In each of these approaches, some aspect of organisation or its working is examined. One can, therefore, expect both similarities and differences as well in these approaches to organisation. The different organisation theories may broadly be classified as follows:

1. The classical theory.

2. The neo-classical theory.
3. The decision making theory.
4. The systems approach.
5. Contingency organisation theory.

The Classical Approach to Organisation

The classical approach to organisational analysis is based on the management process school of thought. It is also referred to as the traditional approach. Those who subscribe to this theory deal exclusively with the anatomy of the formal organisation. They do not take into account the economic, sociological or psychological aspects of the organisational activities.

Max Webber was among the first to offer a systematic approach to the problems of organisation design. Others who have contributed to the classical theory are Henri Fayol, Fredrick Taylor, Mooney and Reiley, Gullick and Urwick.

Classical theory lays emphasis on principles and deals with the structural framework in which grouped activities are assigned to people, authority relations established, individual efforts properly coordinated and responsibilities fixed. The structure is created to help accomplish enterprise goals more effectively.

According to the classicists, co-ordination constitutes the essence of organisation. In other words, it is the orderly arrangement of groups effort (co-ordination) which can provide the necessary unity of action in the pursuit of a common purpose. The foundation of classical theory rests on what are known as the four pillars of formal organisation. The pillars are essentially the classical prescriptions of techniques for rationally structuring the organisation.

Pillars of the Classical Theory

(i) *Division of labour* is the most important of the four pillars. As the human organisation grows in size, work must be divided or broken down to provide for specialisation. Without division of labour, each job would be so inclusive that its performance would be far from efficient.

(ii) *Scalar and functional processes* constitute another pillar which deal with the vertical and horizontal growth respectively. The scalar process refers to the growth of the chain of command which results in levels added to the organisation structure. The scalar process is accomplished through the delegation of authority and creation of responsibility. Functional process is the method by which the organisation grows horizontally. It leads to the departmentalisation of functions.

(iii) *The structure of an organisation* is another pillar which refers to the relationships that exist among the various activities performed in an organisation. The structure implies a pattern and system. Its purpose is to provide an orderly arrangement among functions and activities so that the objectives of the organisation can be achieved effectively.

(iv) *The span of control* is the fourth pillar which is related to the number of subordinates a manager can effectively supervise. To enable managers to control and supervise the subordinates, the span must be restricted depending upon the number of inter-relationships which grow among

individuals when people are added to a department.

Classical Principles of Organisation

The counterparts of the pillars of classical organization theory are expressed as principles. Subordinate to the over-riding principle of co-ordination, the classical principles of organisation most often cited are (a) the scalar principle; (b) the functional principle; and (c) the line and staff principle.

The scalar principle prescribes that with the vertical growth of an organisation, there must be unity of command and determinate hierarchy. Co-ordination is facilitated if a person is accountable to one and only one boss in a hierarchical system where formal authority is clearly defined.

The functional principle requires grouping of activities in accordance with the functions of the organisation. As the number of specialised activities increases, the effects of growth are felt in an enlarged number of functions and in the emergence of staff activities. Hence, it was necessary that the span of control should be restricted to a small number of subordinates. According to the line and staff principles, there should be staff specialists to advise line managers in discharging their functional responsibilities.

The classical theory has encountered a lot of criticism. Herbert A. Simon, for instance, termed a number of classical principles as no more than proverbs and being simple generalisations devoid of predictive power. In any case, a number of these principles are too broad to provide any aid in the actual task of organisation. For example, the principle of division of labour or that of coordination hardly provide any help in actual work situations. Principle of span of control is also criticised on the ground that actual spans in a number of companies are found to be wider than permitted by the classical theory.

A much more serious criticism of the classical theory comes from the exponents of behavioural school of thought. Classical theory of organisation is based on the assumption that productivity of the worker is a function of economic incentive and efficient organisational design. Hawthorne Studies and later research on the other hand, suggest alternative propositions as challenges to the approach. It is argued that the classical theory is too mechanistic and ignores a number of important aspects of human behaviour. By creating the structural framework based on formal activity-authority relations, the organisation conceived in terms of classical approach satisfies largely the physical and security needs. The higher level needs, such as the need for “self- actualisation” (self fulfillments) are not cared for by the classicists. Interaction of individual personality conflicts, informal groups and participation are factors largely neglected by the classical theory of organisation.

However, it would be unfair if the classical approach to organisation is labelled as dubious. No doubt, the classical theory failed to incorporate and consider the significant contribution of behavioural sciences in a systematic manner, yet the view of classical theorists cannot be ignored. Indeed technological and human elements are being increasingly recognized, and the organisation structure is not considered as being exclusive of social needs of its personnel. Motivational factors, informal groups and participation are some of the aspects being reconciled to by the classicists. At the same time it is also true that the first requirement for every student and practitioner of management is to fully understand organisation in the classical sense

and then proceed to study it from the viewpoints of behavioural theory and other approaches. If not altogether logical, such an outlook is definitely more practical and convenient. It should also be remembered that the classical principles of organisation are intended to provide general guidance and not to be used as immutable laws.

The Neo-Classical Approach to Organisation

The neo-classical theory has been associated in the past with the human relations approach. It is now broadly identified with those who recognise and attempt to compensate for the deficiencies of the classical theory. Here emphasis is not so much on specific directions for organising an enterprise as it is on pointing out the factors not covered by the classical theory. While designing an organisation structure, the people in it and their behaviour should be given due cognizance. It should be recognized that every individual, his needs and values need be considered accordingly while designing any system of motivating the employees. Maslow emphasised the hierarchy of needs as basic, social and ego needs. Once, basic and social needs are largely satisfied, ego needs provide the most important source of motivation. The human relations approach also lays emphasis on systematic treatment of informal organisation as an important factor contributing to the satisfaction of needs. Chester I. Barnard, the most powerful exponent of the social system concept of organisation, considered informal organisation as joint personal activity without conscious joint purpose. No management can altogether eliminate informal organisation and as such, it should create conditions under which informal organisation contributes to the accomplishment of goals of formal organisation. Management should also be conscious of the fact that organisation is composed of a number of variables and that an attempt to change any of them is likely to produce the chain of reactions.

The behaviouralists also believe in imperfections of authority delegation and functionalisation processes. It is said that the principles of scalar chain and functional processes under classical theory of organisation have only theoretical validity and tend to deteriorate in practice. A number of human causes are responsible for it. Thus, orders and policies even when plainly stated are subject to reinterpretation by people in the organisation depending upon the psychological set of conditions, environment and the conflicting pressures under which they operate. At the same time, leadership is also described as an important factor in organisation.

The human relations approach has made valuable contributions to the theory of organisation. But like classicists, doctrines of the behaviouralists also suffer from incompleteness and lack of integration among the different facts of human behaviour. While placing major emphasis on group interactions, participation, communications, self-realisation and inevitable conflict among personnel in the organisation, the human relations theory has a tendency to overlook the need for hierarchical authority. It must be admitted that good feelings do not arise spontaneously and that authority structure is required to obtain cooperation from people largely based on persuasion though at times it may be coercive. Requirements of job satisfaction and willing cooperation do not altogether eliminate the need for scalar chain.

Since human motives and behaviour constitute the central theme of human relations theory, which are complex and difficult to predict, one should not expect it to offer a complete basis of organisation. In fact, human relations approach to organisation is more an attitude than a set of principles of organisation. It is largely

intended to visualise the factors and variables not adequately covered by the classical theory.

Thus, the important contribution of the human relations theory of organisation has been to warn the classicists not to treat organisational participants as machines but accord due respect to the values and needs of the people. In fact, the difference between the classical approach and the human relation approach is largely that of emphasis and not so much of complete disagreement. Whereas the classicists consider organisation to be a science, the behaviouralists tend to view sociology and psychology as the underlying science. But it is not contended that the classical model cannot be modified. Urwick and others have realised the need for modifications in organisational principles particularly in view of the new discoveries. Fayol even went to the extent of asserting the principles of organisation should be used as general guides and not as immutable laws. It is further evidenced by increasing emphasis on motivation and human behaviour within the broad framework of classical principles. Similarly, the behaviouralists tend to recognise that happiness and job satisfaction do not eliminate the need for organisational hierarchy.

The Decision-Making Approach

The next approach to organisation is commonly known as the decision-making theory. Herbert A. Simon[1] though influenced largely by the views of Chester I. Barnard, incorporated some of the findings of small group research in the theory which is one of decision-making as well as of organisation. Simon regards organisation as a structure of decision-makers. In an organisation decisions are made at all levels, important decisions tend to be made at higher levels. Decision of an individual is based on the premises of his personal consideration, social environment and also the communication he receives from other parts of the organisation. Though top management is not in a position to dictate to each and every member of the organisation what his decisions should be, it can certainly influence to a large extent the premises on which decisions are based, more particularly the premises provided by transmission of appropriate communication and information necessary for decision. So viewed, organisation should be structured in terms of the points at which decisions must be made and also the persons from whom information and influences must flow so that decisions are effective. Simon has postulated three stages of decision-making:

(i) the intelligence activity, i.e., discovering when and where it is necessary to make a decision;

(ii) the design activity, i.e., finding and developing alternative courses of action; and

(iii) the choice activity, i.e., making the actual selection from among the alternatives developed.

The decision-making approach to organisation accepts the hierarchical form of organisation, but suggests a few modifications with regard to division of work. A decision which approximates the prescribed procedure is described as the programmed decision. If on the other hand, there is no precedent or past experience to go, decision relating to such a problem is described as unprogrammed. The latter

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[1] See Administrative Behaviour by Herbert A. Simon.

type requires maximum use of intelligence of human being. Simon suggests that an enterprise should programme as many decisions as possible by encouraging habits, installing clerical procedures and routines, or by building the right organisation structures and values.

A significant trend in the decision-making approach has been the increasing emphasis on development of management science research and increasing application of mathematical techniques to decision-making. Mathematical programming has been quite successful in solving problems requiring simultaneous consideration of large number of variables.

The Systems Approach

The systems approach looks at the organisation as a total system comprising of a number of interacting variables. Under this approach, organisation is viewed not merely as formal arrangement of superior and subordinate positions or a social system comprising informal organisation and people's influence on each other, but a total system of formal organisation, individuals, social system, the physical setting (man-machine systems), and the environment constantly interacting with each other.

The systems approach studies the organisation as an integrated whole encompassing many sub-systems and considers each system as a part of a still large system. The central theme here is the enterprise objectives, which the system along with its sub- systems intends to help accomplish in the most effective and orderly manner. Since results are influenced by a number of internal and external forces, management should analyse and study all those parts of the environment that effect the achievements of objectives. Objectives thus provide the essential link between the enterprise and those parts of the environment which are important for its stability and growth.

The systems approach does not view organisation as a static arrangement of jobs but calls for identifying the functions required in terms of the decision areas involved in achieving goals. It is in contrast with the classical approach and calls for developing a pattern of inputs, outputs, feedback, delays and flow of material information. Frequent internal and external changes cause disturbances in the organisation, Evidently, for survival and growth of the enterprise, it becomes imperative on the part of management to adjust different variables in order to enable these functions in an orderly way and for the preservation of organisational integrity.

Different components of a system are inter-related and cause interaction; yet certain processes are involved in linking them together so as to maintain the whole system steady. Communication, for instance, connects the different segments of the system together and links the decision centers into a synchronised pattern. Moreover, in the face of changing conditions, different parts of the system have to be adapted so as to maintain them in balance. Whether a change falls within the limits of programme of action initiated as a result of change being perceived, or where the change is relatively a minor one, it might be expected that adaptation to change will be quasi- automatic. Such a quality of the system is referred to has "homoestatic" property of the system. But it is erroneous to conceive of one best way of achieving homoestatis. When adaptation to change is outside the scope of existing programmes, it creates the need for innovation, meaning that search for possible alternative action to cope with the change should be made.

A system is characterised by arrangement of variables and constants interacting with each other. Sometimes projecting the effect of any particular decision or change in environment or the total system becomes highly complicated and calls for use of higher mathematics and a computer, which is not favoured by a large number of people in the organisation.

The classical principles are still widely used in organising and findings of the behaviouralists can be utilised within a largely classical structure. The decision theory does not altogether reject the organisational hierarchy whereas the systems approach is still being developed and can be used in conjunction with the classical theory or the human relations approach to organisation. However, research on organisation tends to move away in favour of the social system approach or the systems approach.

Simultaneous consideration of underlying bases of different approaches to organisation is sufficient to confuse the organiser. However, the practical man should not worry much about the controversy between different theories of organisation. While organising, he should be guided by objectives to be accomplished, availability of resources and type of people he is dealing with. He should try to increase organisational effectiveness by attempting to adapt and cope with changes in the environment.

Contingency Organization Theory

Open system theory recognizes environmental input, but the contingency approach goes one step further and relates this environment to specific organization structure. It recognizes that different organizational structures and processes are required for effectiveness in different kinds of environments. What is an appropriate organizational design in one environment may not be appropriate in another. Since environments change, there is even the need for flexible organizational designs so that they can be changed gradually to keep abreast of the changing environment. The contingency point of view required a fundamental change in philosophy from the traditional view there is one best way of organizing.

Contingency Approach to Management

According to contingency approach to management, there is no one best way to manage. Each organisation is unique. Each situation is different and calls for a contingent approach which requires understanding of their relationships in each case.

The idea of this approach which is also known as ‘situational approach’, is that the internal functioning of an organisation must be consistent with the demands of technology and external environment and the needs of members to be effective and responsive. Different organisations with different tasks and different competitive environment require different plans to meet the situation.

Thus, this approach helps the management in finding solutions to problems in specific situations because the basis of this approach is that the pattern of management is influenced by a number of inter-related internal and external factors since there is no one best way to manage the situation, decides the pattern of organisation and management. This necessitates timely application of manager’s knowledge to realities in order to attain the desired goals.

Contingency approach focuses on management’s main tasks and the relationship

between these. Peter F. Drucker has visualised these as (1) work task, which is focused on today's activities and work performance; (2) innovative task, which provides the ideas, products and work accomplishments for tomorrow's organisation; and (3) task of ownership or top management, which provides the vision and guidelines for joining today's reality with tomorrow's possibilities. Thus, organisations must be flexible and display an ability to adapt to unplanned occurrences. There is no one best way to organise, yet alternative approaches are not equally effective.

Span of Management

An organisation is characterised by the presence of a number of levels and departments. But more the levels are created, more will be the administrative cost due to additional staff required and more will be the difficulties to be encountered in communication and controlling. If this is so, why create departments and levels? Answer to this question is provided by the principle of span of management. This is basically the problem of deciding the number of subordinates to report directly to each manager. The principle states that there is a limit to the number of subordinates that each manager can effectively supervise. The term "span of management" is often referred to as span of control, span of supervision, span of responsibility, or span of authority. But the term "span of management" should preferably be used since span is one of management and not merely of control which is just important function of management.

The problem of span of management is not a new one. Ever since the dawn or organised co-operation, man has experienced and realised that no individual can effectively supervise an infinite number of subordinates. Because of biological and other limitations, an executive can supervise well only a limited number of subordinates. Time, for instance, sets a real limit to the number of minutes in an hour. It takes time to assign tasks, answer questions, direct subordinates, and coordinate the entire work. If the number of subordinates under the direct supervision of a manager is continuously increased, he will finally reach a point of little or no time in discharging his duties effectively. Further, when the manager is asked to control a large number of subordinates keeping in view his time span, supervision will lose much of its quality. Psychologists also point out span of attention as a factor affecting span of management. Similarly, individuals differ in their ability to get along with people and also in the physical and mental energy they possess. Such personality and energy limitations also affect the executive's span of management. Furthermore, no manager is expert in all the things and to that extent he must create limited subordinate positions.

Wide Versus Narrow Spans

Span of management directly affects the number of levels in the organisation. Wider spans of management leads to flat organisation whereas narrow spans of management result in tall organisation structure. The principle of span of management does not by itself resolve the conflict between the advantages to tall organisation and that of a flat one.

Narrow spans lead to many levels in the organisation and thus require a larger number of managers. This, is turn, leads to larger expenses in the form of executive remuneration. Expenses are further increased on account of additional clerical and

office staff needed as a result of there being larger number of managers. The process of control also gets complicated when there are narrow spans and too many levels in the organisation structure. Another serious problem in having too many levels in the organisation is posed by the practice that communication must flow through proper channels only. The more the levels in the organisation through which the communication must pass, the greater will be the danger of its being misunderstood, misinterpreted or distorted. Since the number of levels through which orders, plans and policies must pass increases, there is also the real danger of subordinates away from the top leadership losing even their desire to understand them properly. If subordinates are allowed to communicate directly, the immediate superior will find himself in the most precarious position of the matter being disposed of without his knowledge or having come to know of the information after being communicated to others. However, the effective solution to this practical problem lies in encouraging lower level managers to develop cross relationships.

Narrow spans also adversely affect employee morale. A subordinate who finds himself submerged at the bottom of the organisation pyramid feels sensitive about the fact that he hears nothing from the top leadership. Moreover, due to such placement he gets very few opportunities to develop self-reliance and initiative and enjoys hardly any feeling of belongingness. All these factors make the employees less enthusiastic in their jobs and greatly reduce their morale.

Narrow spans also reduce opportunities for management development. Too many levels hardly allow for delegation of any real authority and greatly limit the supervision to a very few activities at lower levels. The result is that the subordinate is deprived of the benefit of managing a larger number of related activities.

Supervision of too many people on the other hand, can also lead to trouble. Supervision will become less effective because the manager will not have sufficient time and energy to attend to each of his subordinates. Large number of contacts required may also distract him to the extent of neglecting important questions of policy.

The above considerations of narrow and wide spans of management point to the imperative need for a balance. Advantages and disadvantages of these two situations should be carefully examined in terms of tangible as well as intangible factors; and actual span of management should be determined keeping in view all the pertinent factors in a particular situation and at a given time.

Factors Determining the Span of Management

Theoretical and practical variations in span of management are so wide that one needs help in deciding the number of subordinates to be supervised effectively at each position in the organisation structure. Time and attention required; and personal abilities and influences are some of the factors having a bearing on the number of subordinates that can be effectively supervised by a manager. But a host of other factors go a long way in determining what spans are feasible in a given situation.

1. Time Required to be Spent on Supervision

Every manager spends part of his time in doing the job personally. Thus, the sales manager must devote part of his time in contacting customers. Besides, every

manager must also be busy for part of his time with administrative job of planning and policy-making not directly related to guiding the subordinates. Evidently, the time left can be spent on supervising the work of subordinates. The more is the time required to be devoted to processes other than supervision, the narrower should be the span of management for such an administrative position.

2. Subordinate Training

A well trained subordinate is able to do his job quite successfully. Consequently the frequency and severity of superior-subordinate relation stands greatly reduced. Thus, a manager dealing with trained subordinates can afford to supervise a large number of them and operate with a wider span. But training becomes more and more difficult as one goes up the echelons of management hierarchy. At lower levels, it is much easier to identify the areas of training and develop suitable techniques for imparting it. At higher levels, on the other hand, it is difficult to discover what to teach and how to teach. Moreover, while relying upon ability and training of the subordinates as a factor influencing span of management, it should be remembered that training is a continuous process.

3. Delegation of Authority

In an enterprise which is effectively organised and structured, management is able to influence and minimise the frequency and severity of superior-subordinate relationships and thus increase its span. An organisation poorly conceived consumes disproportionate time of the manager in counselling and guiding the subordinates. An important symptom of inefficient organisation influencing span of management is to be found in ambiguous or inadequate delegation of authority. If a subordinate is not clear what he is expected to do or is called upon to do something beyond the scope of his authority, he will make more demand on the senior manager and hence operate to reduce his span. Where subordinates are delegated with authority sufficient to carry out the assigned duties and their authorities are clearly defined, i.e., well-trained subordinates would considerably reduce the time and attention of the senior and thus help to increase his span.

4. Degree of Decentralisation

If a manager is to make many of the decisions himself, he will have less time to spare for supervising the work of his subordinates and hence operate with a narrow span. On the other hand, an executive operating under decentralised set-up is relieved of much of the burden of making programmed decisions and can afford to supervise relatively a larger number of subordinates.

5. Similarity of Functions Supervised

Similarity or variety of functions to be supervised by the manager also influences his span of supervision. Where the executive manages similar functions (which are perhaps repetitive also), he becomes well versed with jobs and can handle a larger number of subordinates. On the contrary, activities and functions with a degree of variability and probably more complex in nature, increase inter-relationships and consume more time of the executive to dispose them of and thus, warrant a fewer number of persons to be handled by the supervisor. The top level manager needs to work longer with each of his subordinates than the first line supervisor who largely handles the routine problems.

6. Planning Required of the Supervisor

This factor refers to the importance, complexity and time to be spent by the executive in reviewing the objectives, programming the actions and deciding a number of policy matters. As the importance, complexity and time required of the manager in performing his planning function increases, it will be more prudent to reduce the number of subordinates reporting to him. However, availability of staff assistance and requirement to plan periodically and not on continuing basis will alter the position.

7. Use of Objective Standards

Supervising the subordinates requires that management must know how far plans are being followed and to what extent their performance tends to deviate from plans. He can know the deviations either by personal observation or through use of objective standards. In the latter case, manager is saved of many time-consuming relationships and can concentrate on points of strategic importance, thus widening his span of supervision.

8. Territorial Contiguity of Functions Supervised

Where functions are geographically separated, supervision of components and personnel becomes more difficult and time- consuming. The manager must spend considerable time in visiting the separate units and make use of more time-consuming formal means of communication. Geographic contiguity of functions supervised by the manager, therefore, operates to reduce his span of control.

9. Availability of Staff Assistance

Staff activities are not uncommon in business enterprises. When an organisation is equipped with staff services, subordinates as a result, gain much of their guidance on methods, schedules and personnel problems from staff experts and thus, require fewer contacts with line managers. It is only when the staff fails to run the show smoothly that the manager normally gets involved. Provision of staff assistance thus helps the executive to supervise a large number of subordinates.

Mentioned above are some of the important factors encountered in actual work situations directly affecting the manager's span of management. Though exhaustive, the list is by no means complete. Rapidity of change, control and information techniques developed, and a number of other factors also influence the supervisor's span. While determining the actual span of management for each of the managerial positions in the organisation, analyst should evaluate these factors for each of the managerial positions in the organisation separately and on the basis of his experience the effective span is to be devised.

Operational School Position

The so-called classical school approach to the span of management has tended to deal with generalisations embodying specific numbers of subordinates for an effective span. Empirical data do give support to the classical school consensus of an upper and top level span from 3 to 7 or 8 subordinates. However, more recent operational management theorists have taken the position that there are too many underlying variables in a management situation to conclude that there is any particular number of subordinates which a manager can effectively supervise. But this number will depend upon the underlying factors, all of which affect the difficulty and

time requirements of managing.

If one can look at what it is that consumes the time of managers in their handling of superior-subordinate relationships, and also ascertain what devices can be used to reduce these time pressures, the analyst has an approach that will be helpful in determining the optimum span in individual cases and also a powerful tool for finding out what can be done to extend the span without destroying effective supervision.

Graicunas' Theory of Superior-Subordinate Relationships

V.A. Graicunas, a French Management Consultant, analysed superior-subordinate relations and classified these relationships into three forms:

(a) Direct Single Relationships between the senior and each of his subordinates individually.

(b) Direct Group Relationships between the manager and each of the possible combinations of subordinates.

(c) Cross Relationships between each of the groups of subordinates.

On the basis of analysis of the above relationships, Graicunas developed the following mathematical formula based on geometric increase in the complexities of managing:

$$n\frac{2^n}{2} + n - 1$$

or it can be further simplified as

$$n[2^{n-1} + (n-1)]$$

where 'n' indicates the number of subordinates supervised.

On the basis of this formula, the number of relationships increase from 490 to 1080 as the number of subordinates is raised from 7 to 8.

The formula may not be applicable to a given case, but it has the advantage of streamlining the problem of span of management better than any other device. The formula lacks the merit of taking into account frequency or importance of relationships.

Though there is a general agreement about the necessity of a limit to the number of subordinates reporting directly to a supervisor, the desirable limit is yet an elusive problem. There are both theoretical as well as practical variations in this regard. Prescriptions as to the number are many and some authorities have expressed the span in relation to the exact number of subordinates to be supervised. Much of the attack on principle of span of management is focussed on inflexible statements in relation to which it is expressed. Herbert A. Simon, for example, pointed out that since span of management is determined by a number of complex variables, no formula can be used to determine the optimum span. In fact, successful companies operate with different spans. The principle therefore fails to predict what happens in successful enterprises, nor does it lay down conditions for optimum span of supervision.

In spite of objections to the principle of span of management, it remains a valid proposition that there is still upper limit to the number of subordinates that a senior

can effectively supervise and that the principle when stated in flexible terms cannot be overlooked entirely without incurring considerable risk.

Need for Balance

Despite the desirability of flattening organisations structures, the span of management is limited by real and important restrictions. As the enterprise grows, the span-of-management limitations force an increase in organisation levels.

Therefore, there is a need for balancing of all pertinent factors in a given situation. Widening spans and reducing number of levels may be an answer in some cases, the reverse may be true in others. One must balance all the costs of adopting one course or the other. One needs to understand that the correct principle of span of management is, that there is a limit in each managerial position to the number of persons an individual can effectively manage, but the exact number in each case will vary in accordance with the effect of underlying variables and their impact on the time requirements of effective managing.

AUTHORITY AND RESPONSIBILITY

Nature of Authority

Authority is a term packed with variety of meanings by theorists and management practitioners. In everyday life, authority is commonly understood as rightful power or right to command. Authority is sometimes described as an attribute of the job and not of the man. Thus, Mr. A, as Office Superintendent derives authority over office personnel not as Mr. A but as one occupying the position of Office Superintendent. If this view of authority is accepted, differences in achievement by different individuals on the same job remain unexplained.

Authority may be described as the right of a manager to command subordinates, issue them orders and instructions and exact obedience. Authority is also the right of the manager to make decisions and to act or not to act depending upon how he deems fit to accomplish certain objectives of the organisation.

Fayol defined authority as “the right to give orders and exact obedience”, and viewed this as official authority. He also recognised that official authority vested in the job was often ineffective. Authority is greatly enhanced by personal authority comprising intelligence, experience, moral, leadership quality, etc. But as the key to management job, authority, is conveniently described as the power to command others, to act or not to act in a manner for the purpose of achieving some objectives. An individual without authority cannot occupy the position of a manager. It is authority that makes the managerial position real and vests in him the power to order his subordinates and secure necessary compliance. In an organisation with a chain of superior-subordinate relations authority acts as the binding force and provides the basis for responsibility. Mooney[1] described authority as “the supreme coordinating power”. Delegation of authority is one of the important means of securing coordination in the organisation. Without authority there would be no superior-subordinate relations and organisation would run to chaos and anarchy.

Authority to command exact obedience is also known as the official authority or authority of position which a manager enjoys by virtue of his position in the

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[1] The Principles of Organisations by J.D. Mooney.

organisation. But a person may have the ability to influence the behaviour of other people in the organisation. This is known as personal authority or owner of the manager. Official authority of a manager becomes more effective when supported by his personal authority. Very often managers are found avoiding the term authority because of the impression of power associated with it and speak of having responsibility delegated to them though it is authority which is delegated and not the responsibility. Similarly, authority should not be confused with unlimited power. It should thus be clear that authority consists of certain permissions or rights to act for the enterprise in some specified area.

Responsibility

Very often we hear of 'delegating responsibility', 'carrying out a responsibility', 'discharging a responsibility', 'possessing responsibility', and the like statements. Such statements are a pointer to the fact that responsibility is a term clogged with variety of meanings in the field of management. It is frequently described as an obligation to perform a task or as the task itself. Those who accept the task should be held responsible for their performance. The basic essence of responsibility is obligation. However, in the context of hierarchical relations in the organisation, responsibility may well be described as the obligation of a subordinate to perform the duty or tasks assigned to him. Responsibility should then be construed in relation to a person and no other object. Implied in this is also the assumption that responsibility is founded on and emanates from superior-subordinate relations established in the organisation. Thus, manager has the right to get the duty performed by the subordinate to whom it has been assigned and authority delegated for its proper discharge. From the above, it follows that authority flows downward whereas responsibility is exacted upward.

Moreover, responsibility is always in relation to a person and never in relation to a thing. The basis of responsibility is superior subordinate relationship existing in the organisation. The superior exacts responsibility from the subordinate to whom task was assigned for performance of the assigned task. For the subordinate responsibility is owing by him to the senior for performance of the duty assigned to him.

Emergence of informal leadership sometimes creates problems in clearly defining responsibility of the subordinates. Thus, where the assistant sales manager is influenced by and looks forward for guidance of the production manager, the basic structure is altered though formally sales manager's responsibility to Chief Executive is not changed and assistant sales manager remains equally responsible to the sales manager. Classical organisation theorists emphasise responsibility only in the formal sense and advocate its clear definition on the grounds of avoiding confusion, omission and duplication. It is in contrast with the 'free form' of organisation where organisation chart, functions and plans are not reduced to paper work only.

One important sense in which the term responsibility is confused is when people talk of delegation of responsibility though what is really delegated is authority. Responsibility is absolute and cannot be delegated. Responsibility, in the sense of obligation of the subordinate is not pushed down in the organisation; instead, new responsibilities must be created at each level. The board of directors is responsible for the whole of the enterprise irrespective of the extent to which authority is delegated down the levels of organisation structure. If things go wrong because of wrong actions on the part of the subordinates at middle or lower levels of

organisation, top management is still to account for the state of affairs of the enterprise. Thus, the manager assigns duties to the subordinates, delegates authority for their execution and exacts responsibility from them. It is, thus, accomplishment of tasks which can be delegated and not the responsibility. By assigning tasks and delegating authority, manager does not absolve himself of any obligation he undertook, rather he creates a new set of obligations to himself.

Accountability

Accountability denotes answerability for the accomplishment of the task assigned by the superior to his subordinate.

It is to be noted that the process of delegation is not at all complete with just assigning the duty and delegating appropriate authority for the accomplishment of the task. The process of delegation becomes complete only by making the delegatee answerable to the superior for his functioning.

Thus, if the publicity manager of a company is assigned with the task of formulating and implementing a mass publicity plan for a new product, he is answerable for its effectivity. Similarly, production managers are answerable about the production, sales managers about sales, purchase managers about purchase of raw materials. It may be mentioned that in all cases, managers delegate their authority to the subordinates creating a particular responsibility and keeping them answerable for the accomplishment of the job to them. In this way, authority goes down and down in the line making everyone accountable for the duty assigned.

Sources of Authority

Earlier, management students and practitioners took authority for granted and did not care much for its origin or source. Henri Fayol viewed authority as the right to command and the power to exact obedience. Clothed with it are the sanctions, reward or penalty that go with the use of authority. But gradually disagreement has developed as to the source of authority. There are broadly two theories regarding source of authority formal authority theory and the acceptance theory.

The Formal Authority Theory

The formal authority theory traces the source of authority upward from any managerial position. Thus, the foreman derives his authority from the assistant production manager, assistant production manager from the production manager, production manager from the chief executive, chief executive from the Board of directors, Board of directors from the shareholders and so on. But the authority which is so derived by the shareholders and the manager is limited by laws, government control and regulations, political and ethical considerations and by the economic institutions of competition, labour unions, and the like. Thus, the formal authority theory views authority as being transmitted from the basic social institutions to the individual managers. In private enterprises, authority originates from the top in the institution of private property as modified by the legal system of the country and other social institutions and flows through owners to the managers representing them and consequently to their subordinates. In social groups where private property does not exist, the origin of authority may be traced back to the basic group behaviour and the social institutions of politics, education and religion.

The Acceptance Theory

Some theorists and practitioners do not agree with the formal authority theory. In their search for a source of authority they look at the bottom of the organisational hierarchy where objectives are finally achieved. It is at this level that final decision is made to accept or reject the activity specified in the communicative directive. Chester I. Barnard in his treatise 'The Functions of the Executive', viewed that "authority is the character of a communication (order) by virtue of which it is accepted by a contributor as governing the action he contributes; that is, as governing or determining what he does or does not do as far as the organisation is concerned". He further argues that the necessity of assent of the individual to establish authority for him is inescapable. According to this view of authority, one must know the conditions under which the recipient accepts the communicative directive as authoritative and acts accordingly. Barnard suggested four conditions for this to be simultaneously met:

(i) The recipient of the directive understands it.

(ii) The directive does not appear to be inconsistent with the purpose of the organisation.

(iii) The directive is not incompatible with the purposes of the recipient.

(iv) The recipient is mentally and physically able to comply with directive.

It is only when these conditions are fully met that co-operation is secured and authority conferred upon the directive. Thus, the manager enjoys real authority only when the individual subordinates confer it upon him by accepting the communicative directive as authoritative.

Importance of acceptance by subordinate of the authority of the senior on the basis of conviction and understanding is being increasingly recognised and appreciated. But subscribing to acceptance theory is difficult proposition. Firstly, there is always an implied understanding that he must agree to obey his higher-up. If the manager finds subordinate not accepting his directive, he has power to grant or withhold rewards, to penalise or even to dismiss. Such a situation exposes the unreal characteristic of the acceptance theory. Secondly, if acceptance were the source of authority, the manager would not be in a position to know whether he would be obeyed or disobeyed. This makes his task of commanding a precarious one. Further, when subordinate enjoys the right to confer power upon the manager, he must also have the right to levy sanctions. Next, the acceptance theory totally disregards the powerful sanction and effect of the social institutions upon the authority. Can we deny the impact of, say, legal system upon the authority of the manager? Moreover, authority is fundamental to the job of a manager and a supreme coordinating power in the organisation. If its compliance is left to the liking or acceptance of the subordinate, chaos will follow. Thus, the acceptance theory of authority has the overtones of leadership more than that of authority. Leadership and authority both are essential to the job of managing; but authority is much more than merely securing compliance of subordinate.

The Competence Theory

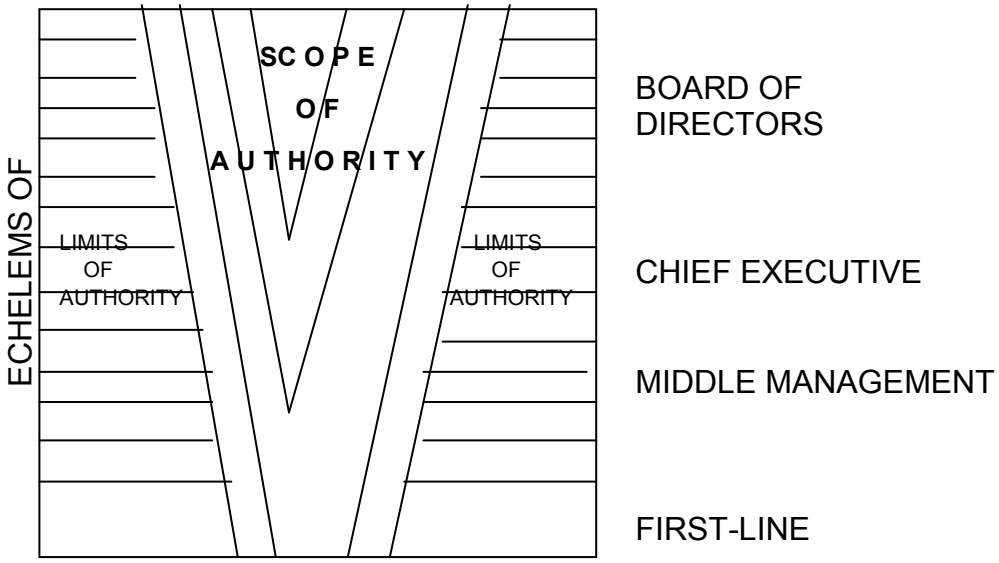
The competence theory is more closely related to the acceptance theory of authority. Very often words of a few individuals carry more weight and are easily accepted by other people in the organisation irrespective of their position in the managing hierarchy. Undenyingly, this is due to competence, better abilities, personal

qualities or intelligence of such individuals in the organisation. The real source of a man's authority is then described to be his competence.

The competence theory is also partial in its approach to the source of authority and suffers from more or less the same criticism as is levelled against the acceptance theory of authority.

Limits of Authority

A simple look at the organisation structure is sufficient to point out that the top management headed by the Board of directors and the chief executive enjoys wider authority while its scope gradually narrows down as one descends the levels of organisation structure. Thus, the extent and scope of the right to command tend to increase as one proceeds up from the lowest to the highest echelons of management hierarchy. The scope and limits of authority from the top to the bottom of the organisation may be visualised as an inverted pyramid with the first line supervisor at its bottom, indicating that there are more limitations on the scope of authority as one descends the managerial hierarchy. The Figure broadly indicates this characteristic of authority.



No manager enjoys unlimited authority. His authority is subject to definite limitations, internal as well as external. Like all other social institutions, authority is also subject to change. Group behaviour, code and norms of subordinates exercise restraints over powers of the manager. Different social groups in the organisation react in their own ways. Thus, there are social limitations on the exercise of authority.

Company policies, procedures rules and programmes also limit the executive authority. The very fact that the manager must act strictly within the accepted company policy and in accordance with the established procedures is itself a serious limitation on his authority. Any behaviour or act of the manager inconsistent with company policy or objectives is likely to invite criticism and at times invite reprisal. Thus, where promotions as per company policy are required to be made from within the organisation, no manager has authority to promote people from outside the

organisation.

When a manager delegates authority to his subordinates, he reserves certain matters for decision to himself and may place substantive limitations on the authority of his subordinates. Thus, limitations spelled out in the assignment of duties and delegation of authority also act to reduce power of the subordinate manager.

Nevertheless, limits to authority are laid down by the provisions of partnership deed (in case of a partnership concern), memorandum and articles of association of the company along with decisions and resolutions passed in the Board Meetings. And if company executives respect the deeds of incorporation and its by-laws, their authority obviously gets restricted.

Other limits to authority are placed by the fact that executives do not have capacity to do certain things. Besides physical and technological constraints to do the impossible, there are economic and legal limitations on the authority of the manager. Policies and strategies of the competitors and legal requirements having a bearing upon bargain with different parties or groups (more particularly with labour) tend to limit managerial discretion and power in these matters.

Authority – Power Continuum

The limits to formal authority is sometimes explained by making a distinction between authority and power. It is suggested that authority may be regarded in the official hierarchical sense as the right to command and power may be regarded as the capacity to influence the behaviour of others. In reality, managers having authority may be found also to have power to secure obedience in different proportions. At one extreme, right and capacity may be combined in equal proportions, while at another extreme right and capacity may be completely separable. For instance, the head of a division of the Army usually combines authority and power more completely. On the other hand, the foreman of a printing press may have authority over skilled subordinates but may not be able to wield power equally over them in view of the subordinates' superiority of skill. Hence, one should consider authority and power constituting a continuum.

Balance of Authority, Power, Responsibility and Accountability

Ideally, authority, power, responsibility and accountability should be equal to each other in every position in the firm. When any one is out of balance with the other, problems can arise. When authority in a position exceeds power, the person holding the job can't be effective. He will be unable to use rewards and punishments to enforce authority. Even where authority and power are equal, they must be matched by responsibility and accountability. Otherwise the position holder may pass the buck to someone else, when his actions cause problems.

Delegation of Authority

Delegation, according to L.A. Allen, "is the process, a manager follows in dividing the work assigned to him so that he performs that part which only he, because of his unique organisational placement, can perform effectively and so that he can get others to help him with what remains". A single individual cannot manage and control every activity of the business enterprise owing to his limitations, both physical and

mental. There is a limit upto which a person can supervise the subordinates. When the number of subordinates increases beyond a limit, he will have to delegate powers to those who will perform supervision for him. A manager is not judged by the work he performs on his own but the work he gets done through others. He assigns duties and authority to his subordinates and ensures that the organisational goals are achieved. Delegation is an administrative process of getting things done by others by giving them responsibility. Authority is the degree of discretion conferred on people to make it possible for them to use their judgement. As the organisation grows there is a need to delegate authority to more and more people to cope with the volume of work. Delegation of authority entails division of work load and sharing responsibility. Degree of delegation really depends upon manager's degree of management capabilities.

Various advantages of delegation of authority make a manager delegate some of his authority. A clearly defined authority-responsibility relationship helps the manager in maintaining healthy relationship with the subordinates. It enables the manager to get the benefit of specialised knowledge and paves the way for efficient functioning of the organisation. Delegation is a basic administrative technique essential for management of business enterprises. No organisation can ever function if authority is not delegated. While delegating authority, the manager does not delegate responsibility.

It has already been observed that authority is key to the management job, and a manager without authority ceases to be a manager in the formal sense. In the same way, authority delegation is the key to organisation. In fact, no organisation is possible without delegation, because it presumes non-existence of subordinates in the organisation and one man doing everything. While establishing organisation structure, the manager must group activities, assign them to different individuals in the organisation and delegate authority necessary for their effective and efficient functioning to achieve the mission of the enterprise. Delegation is thus an essential process indispensable to organisation. Principle of span of management also requires authority to be delegated to subordinates. It is obvious, therefore, that when the manager delegates authority, he creates subordinate positions and thereby makes the organisation possible. No organisation can ever function if authority is not delegated. A manager delegates the authority when he assigns tasks to individuals, gives them the authority to perform the tasks and exacts responsibility for their performance from the subordinates.

The Process of Delegation

Irrespective of the level at which authority is passed on to subordinates, delegation can be conceived of as a four-step process as follows:

Allocation of duties

Duties are the tasks and activities that a superior desires to have someone else to do. So, before authority can be delegated, the duties over which the authority relates must be allocated to subordinate.

Delegation of authority

The essence of the delegation process is empowering another person to act for the manager. This is a passing of formal rights to act on behalf of another.

Assignment of responsibility

When authority is delegated, one must assign responsibility. That is, when one is given “rights”, one must also be assigned a corresponding “obligation” to perform. Here it is important to recognise the importance of equating authority and responsibility. To allocate authority without responsibility creates opportunities for abuse, but no one should be held responsible for what one has no authority over.

Now a question may arise as to when responsibility cannot be delegated, how can its parity with authority be ensured? Actually, one has to recognise two forms of responsibility: operating responsibility and ultimate responsibility. While the former can be delegate the latter is absolute.

Creation of accountability

To complete the delegation process, the manager must create accountability; that is, subordinates must be held answerable for the discharge of the duties assigned and the judicious use of authority delegated.

Thus, duties, authority and obligation constitute three important ingredients of delegation. All the three aspects of delegation are inseparably interrelated and a change in one is bound to call for adjustment in the others.

Barriers to Delegation

Though an elementary art of management, delegation of authority represents the most important test of executive competence. It should, therefore, be well practised. A number of working rules and fundamentals have been developed to make delegation more effective. But as an art, it has to be properly understood and learnt.

Delegation can be both defensive as well as aggressive. When authority is delegated to alleviate pressure on over burdened top management, it is described as defensive. The executive may also delegate authority not necessarily to reduce his burden but as an aggressive move to secure the benefits of direct and immediate decision-making by pushing the authority down to decide matters as near the point of action and information as possible. But there are quite a few managers who prefer to withhold a larger part of their authority under the pretext that even after delegation they still continue to remain responsible for the accomplishment of tasks assigned to them. Such a psychology on the part of some of the managers is self-defeating and causes real limits to delegation.

The problem can partially be solved by using the technique of “over-ride”, which is analogous to the relationship between the human pilot and the automatic pilot on an aeroplane that is self-adjusting and guides the plane towards destination. The human pilot can take over at any time. But such a frequent practice will mean losing the advantage of having an automatic pilot. In the same way, application of the principle of over-ride will enable the manager who delegates authority to subordinates to feel free of detailed considerations keeping the ultimate control in tact.

Certain personal attitudes are also important in making real delegation. Every delegation must involve a degree of authority or discretion. Decision of subordinate is not likely to be exactly similar to that of the delegator himself. It is, therefore, expected that the manager should be receptive, i.e., allow other individuals’ ideas a chance. In the same way, for making delegation realistic and effective in true sense

the manager must not only be willing to push decision-making power down the levels of organisation structure but be prepared to allow others to make mistakes. To give real meaning to delegation it is all the more essential that the manager must believe and trust his subordinates.

Lack of ability to direct well is still another barrier to successful delegation on the part of the top executives. Delegation does not absolve manager of the responsibility to guide, motivate and lead the subordinates. In fact, effective direction goes a long way in improving quality of delegation.

Described above are some of the possible reasons why the manager may fail to delegate. There are also real obstacles to a subordinate accepting delegation. Even when the manager is willing to delegate part of his authority, the subordinate may be reluctant to accept it. Making decisions for oneself is quite a difficult proposition. A subordinate finds it more convenient and easy to take dictation and ask the higher-up rather than to involve himself in the creative process of decision-making. This tendency on the part of the subordinates must be strongly discouraged by the manager through counselling and making him recommend a thorough solution of his own. Fear of criticism may also deter the subordinate from accepting delegation. Lack of confidence is yet another serious problem standing in the way of subordinates accepting the authority. In addition, lack of necessary information and resources to do the assigned duties also make the subordinates feel hesitant in accepting delegation.

Principles of Delegation

Delegation does not always work as smoothly as the manager might expect. To overcome weak delegation and to make delegation more effective, certain guides, rules or principles are enunciated and followed. Some of the important principles are discussed below:

1. Clarity of Delegation

Whether specific or general, written or unwritten, delegation of authority must be very clear in terms of its contents, functional relations, scope and assignments. The delegatee should also be given a clear idea about the tasks assigned, what is expected of the recipient in his own job and how his obligation fits into the general plan. Ambiguity in delegation often leads to poor results and tends to make the delegation less effective.

Principle of clarity of delegation also implies defining in clear terms the horizontal and vertical relationships of the position of each subordinate to other positions in the organisation. That is, every subordinate must know what positions in the organisation structure exist at his own level and how his position fits in the overall management hierarchy. Thus, every manager must know who are working under him and who are occupying positions higher to that of his own in the organisation. This helps him to seek guidance and also to provide guidance in terms of scalar chain established in the organisation.

Specific written delegations help both the manager and the recipient of authority. It helps minimise conflicts and overlaps. But as one goes up the echelons of organisation structure, such specific delegations become more and more difficult.

Principle of clarity of delegation should not be taken to mean that authority

relations between the subordinates and the seniors once established become immutable. As a matter of fact, with change in the work itself, authority delegations should be adequately modified.

2. Delegation to be Consistent with Results Expected

A manager before proceeding with actual delegation of authority to the subordinate should know the jobs and results expected of such delegation. He should thereafter delegate only that much of authority which is just sufficient to accomplish the results. It is an important guiding principle of delegation and rests on the assumption that goals are set, plans made and that jobs are set-up to accomplish or implement them. The principle also helps minimise the dangers of delegating too much or inadequate authority.

3. Responsibility cannot be Delegated

Obligation to accomplish the assigned task is absolute and is not partitioned when authority is delegated to the subordinate. Thus, when the chief executive of a company appoints a sales manager to look after sales, the former does not absolve himself of his responsibility for the same by delegating part of his authority to the latter. The chief executive even after delegation still remains accountable to the Board of Directors for management and supervision of the whole of the enterprise. If this principle is violated, three important consequences will follow:

(i) If the manager is able to pass on obligation along with delegation of authority to the subordinates, the rule of single chain of command will be violated.

(ii) Management at the top shall have great responsibility and yet not be accountable for the results.

(iii) When manager is allowed to delegate even his obligation, there shall be no way of knowing who was accountable for what.

Thus, when authority is delegated, obligations are not passed down the organisation; rather new responsibilities are created at each level.

4. Parity of Authority and Responsibility

Whenever authority is delegated, responsibility steps in and is co-extensive with authority. A subordinate can be held accountable for the tasks assigned to him and to the extent authority delegated for their accomplishment. Accordingly, sales manager cannot be held responsible for production failures for which he was given no authority. Since both authority and responsibility relate to the same assignment, it is logical that the two should be co-extensive. But this parity is not a mathematical one.

There are writers who have challenged the merit of equating responsibility with authority. While accepting the element of truth in this principle, they have raised certain difficulties inherent in the parity. Firstly, duties are concerned with objectives and activities, obligations with attitudes, and authority is related to rights. All the three things are related but lay down different orders. Indeed, it is difficult for the manager to express them through some common denominator and measure their equality. Moreover, authorities and rights which are passed on to the subordinates are subject to substantial restrictions both from within and also from outside the enterprise. These restrictions make it difficult for the executive to measure equality of authority and responsibility. Besides, some managers are prompted to develop a tendency to cover up their failure under the pretext of lack of desired authority. Thus, the principle

of parity of authority and responsibility, though by and large correct is unfortunately an over simplification and “is likely to bring more mischief than good”.

5. The Exception Principle

A manager delegates authority to the subordinate so as to be relieved of the overload which he thinks should be passed on to subordinates or to push down the process of decision-making as near the source of information and action as possible. In such a case, it is expected that the recipient of authority shall make proper use of it and make all the decisions falling within the scope of his authority. Only in exceptional cases when he cannot make the decision at his level, he should refer them upward for consideration and decision by the superior.

By delegating a part of his authority to the subordinate, the manager does not absolve himself of his responsibility. It is, therefore, essential that the manager should device suitable techniques of control so as to ensure that the authority is properly used and results are achieved as expected. Controls should not interfere with the authority; rather report the deviations promptly. In the same way, managers should reward those subordinates who successfully use their authority.

Authority once delegated can always be recovered by the delegator. Change in the company policy, programme, objectives, or the organisation structure are some of the factors that may create the need for recovery of delegated authority.

In an organisation such problems also arise which require pooling the authority of two or more managers together before final decisions can be made. Thus, on a number of occasions the production department has to seek concurrence of the sales department before effecting any major change in the product design. This pooling together of the authority of two or more managers before a problem can be solved or a decision be made, is described as splintered authority.

6. Principle of Functional Definition

To develop departmentation, activities must be grouped to facilitate the accomplishment of goals, and the manager of each sub-division must have authority to coordinate its activities with the organization as a whole. Principle of functional definition also says that the more a position or a department has clear definition of results expected, activities to be undertaken, organisation authority delegated, and authority and informational relationships with other positions understood, the more adequately the individual responsible can contribute towards accomplishing enterprise objectives.

7. Scalar Principle

It says that the more clear the line of authority from the top manager in an enterprise to every subordinate position, the more effective will be the responsible decision-making and organisation communication. Subordinates must know who delegates authority to them and to whom matters beyond their own authority must be referred.

8. Principle of Unity of Command

According to this principle, the more completely an individual has a reporting relationship to a single superior, the lesser will be the problem of conflict in

instructions and the greater the feeling of personal responsibility for results. Therefore, in case of delegation, except for the inevitable instances of splintered authority, the right of discretion over a particular activity will flow from a single superior to a subordinate. Thus, delegation will be more effective when the subordinate receives orders and instructions directly from one senior. This avoids problem of confusion, preferences and divided loyalty.

CENTRALISATION AND DECENTRALISATION

Meaning

Centralisation and decentralisation are not absolute terms. There are varying degrees to which authority can be centralised or decentralised. In fact, none of the executives and managers can delegate all his authority without surrendering his position as a manager; nor can a manager retain all the authority to himself and yet have subordinates in the organisation. Thus, absolute centralisation or decentralisation imply no organisation. Centralisation and decentralisation are, therefore, tendencies and not absolute terms; each has to be gauged by certain norms and tests.

Centralisation refers to the tendency to withhold a larger part of formal authority at higher echelons of management hierarchy. Thus, larger number of decisions and more important of them are made by those occupying higher positions in the organisation. Where, on the other hand, larger part of the authority is delegated down the levels of management so that decisions are made as near the source of information and action as possible, such a tendency and characteristic in the organisation is described as decentralisation. Place of decision-making authority in the management hierarchy and degree of the decision-making power at lower echelons of the organisation are the two important tests used to determine whether mode of working is centralised or decentralised in the organisation. The greater the number of decisions made and the more the functions affected by decisions at lower levels, the greater will be the degree of decentralisation.

Decentralisation should not be confused with delegation of authority. Decentralisation is basically concerned with attitude and philosophy of the organisation and management. It is not merely a process involving handing over part of the authority to the subordinates. Delegation is a process and decentralisation is the situation produced by larger delegation of authority down the levels of organisation. Moreover, a company cannot do without delegation, i.e., delegation of authority is essential in as much as no organisation is possible without delegation. Decentralisation is not of that much compulsion to the process of organisation. Thus, there may be delegation without there being decentralisation.

Advantages of Decentralisation

Advantages of decentralisation becomes the limitations of centralisation:

1. Decentralisation makes for quick decision and improves quality of the decisions by pushing decision-making closest to the situation.
2. Decentralisation helps improve effectivity of managers. Development of self-reliant managers is encouraged. Every manager knows what he is expected to do. Good managers are tested and can be encouraged, whereas weak

managers can be counselled and reprimanded.

3. Democratisation of management is yet another advantage of decentralisation. Those who are governed can assert their voice and share in that governance.
4. Decentralisation provides actual work experience to a large number of middle and lower managers and thus creates a reservoir of promotable managerial manpower.
5. Improved morale of personnel is another great advantage of decentralisation. Managers at different levels and semi- autonomous divisions are able to see by themselves the results of their own actions and ascertain their role and success.

Advantages of Centralisation

Advantages of centralisation are largely absent in a decentralised organisation and become limitations of decentralisation.

1. Uniformity of policy and procedure can strictly be enforced since decisions and controls are largely centralised.
2. Centralisation helps to eliminate overlapping or duplicate activities and thus effects sufficient cost savings.
3. Centralisation helps in fuller utilisation of talents of outstanding executives for enterprise as a whole.
4. Centralisation ensures consistency of operating and uniformity of decision and consequently, helps retain substantial control over activities of the enterprise.

Decentralisation is not an easy process. Both centralisation and decentralisation have their relative merits and limitations. Evidently, it is necessary to consider each in balance with the other. Even in a decentralised company, certain functions are invariably centralised. Moreover, some tasks cannot be decentralised. Thus, importance of trade unions, corporate laws or financial considerations may well compel a company to centralise such activities.

Factors Determining the Degree of Decentralisation

Although the extent of authority delegation largely depends on the attitude and temperament of individual managers, yet many other factors also affect it. Some such factors of overwhelming preponderance may be explained as follows:

1. *Importance and Significance of the Decision:* One of the important factors determining the degree of decentralisation of authority is *costliness of the decision*. Normally, decisions which are costly in terms of money value involved or in terms of factors like goodwill and image of the establishment, employee morale or motivation tend to be centralised at the upper levels of management. In other words, it is very rare that authority for crucial decisions is delegated. Of course, the practice is not based on the assumption that people at the higher level in the managerial hierarchy do not make mistakes. It is believed, however, that higher level executives commit fewer mistakes since they are well-trained and experienced; and in possession of adequate information necessary to arrive at the decision. In fact, it is observed from the mode of managerial behaviour that the determining factor to centralisation of authority with regard to specific area or areas is the weight of responsibility since

authority delegation does not implicate responsibility delegation.

2. *Size of the Enterprise:* Another pertinent factor determining of decentralisation is largely the *size of the organisation*. There is no denying the fact that larger the firm, the more the decisions to be made inviting number of departments and levels, the harder it is to coordinate them. Moreover, a number of executives and specialists need to be consulted in big establishments. In essence, decisions are often being delayed though delayed decisions cost much.

Diseconomies of large size may be greatly reduced by organising the enterprise into a number of decentralised units resulting in economy and efficiency. Of course, exactness of the size, till now, is a controversial matter. Nothing in particular or categorically can be prescribed. But it is to be appreciated in all circumstances that the size of each individual unit should be so determined that departments or units are easily manageable with authority considerably decentralised.

3. *Management Attitude and Philosophy:* Decentralisation is largely a question of character of top executives and their attitude. It may be noted that outlook and attitude of top management is, undoubtedly, a significant determinant of the extent and mode of authority dispersal. It is certain that an executive with traditional rigid outlook hardly contemplates delegating substantial authority. On the other hand, people with rational managerial temperament believe and want to rely upon participative approach of doing the work and are anxious to take maximum opportunity of individual initiative in the organisation, opt for decentralisation.

4. *Control Techniques:* Another related factor determining the degree of decentralisation is the magnitude of desire to obtain uniform policy with regard to such vital factors as price of a product, service, delivery, credit, etc., which can best be practised by centralised authority. And there is no denying the fact that such a standing belief deters them from delegating authority to others - even to executives of regional offices.

Of course, the internal advantage of uniform policy cannot be undermined altogether. But, in the same event, costs involved to centralise decisions must also be taken into account. It is further to be appreciated that centralisation is likely to arrest individual initiative, dampening future growth of managerial personnel from within the organisation.

5. *Availability of Capable Executives:* Nevertheless, availability of capable executives substantially determines the nature and extent of dispersal of authority. It is not uncommon that top executives willing to delegate authority find themselves handicapped in that respect for want of capable and qualified subordinates. Obviously, the key to safe decentralisation is adequate training of subordinates and make them able to shoulder higher responsibility effectively. And perhaps it would be interesting to note that decentralisation provides possible opportunities to impart the training required.

6. *Environment Influences:* So far the determinants of the extent of decentralisation that have been analysed belong to the interior of the firm. But certain external forces are also significant in determining the mode of decentralising authority. There should not be any controversy over the fact that forces like government controls, national unions, fiscal policy of the government, government purchases, etc., to a considerable length determine and mould the extent and nature

of decentralisation of any organisation.

In fact, these forces on many occasions deter the management of an enterprise to delegate authority down the echelon since many aspects of the functioning are virtually controlled by such external forces. Say, for example, when raw material is subject to government allocation, the extent of authority that can be given to purchasing and factory managers is really a point of argument. Likewise, if pricing of any product is subject to regulation, hardly any authority could be given to sales manager to exercise and assert.

Delegation and Decentralisation

Even though both delegation and decentralisation involve dispersal of authority following are the points of distinction between the two:

Points	*Delegation*	*Decentralisation*
1. Nature	Delegation is individual. It usually involves two persons. Supervisor and subordinates.	Decentralisation is totalistic in nature. It involves delegation from top management to the department or division of sectional level.
2. Control	Control rests with the delegated or the supervisor.	In decentralisation management exercises minimal control. All powers are given to concerned departments or divisions or sections.
3. Need	Delegation is essential to get things done by others. Unless otherwise authority is delegated it will be difficult to assign responsibility.	Decentralisation is optional because it depends upon the philosophy of management. Top management may or may not dispense authority.
4. Responsibility	In delegation, responsibility remains with the delegator. He can delegate authority but not all responsibility.	In decentralisation, head of the department is responsible for all activities under him. He is required to show better performance of the whole department.

It would be seen from above that decentralisation is a fundamental phase of delegation. It is an extension of the concept of delegation. According to Allen, decentralisation is the systematic effort to delegate to the lower levels all authority except that which can be exercised at central point.

SELF-TEST QUESTIONS

1. Define the term “Span of Management”. What are the factors determining span of management?
2. Explain the concept of authority. What are the main sources from which authority comes?

3. What is delegation of authority? Explain briefly the principles of delegation.
4. What is decentralisation? Discuss the main factors affecting the degree of decentralisation in an organisation.
5. Write short notes on the following:
   (i) Graicunas, views on span of management.
   (ii) Tall and flat organisation.
6. "Delegation is a must for decentralisation". Explain this statement.

Suggested Readings:

(1) Management: Analysis, Concepts and Cases — *Hayness and Massie*
(2) Principles of Management — *George R. Terry*
(3) Formal Organisation: A System Approach — *Carzo and Yanou*

STUDY XI

ORGANISATION (II)

DEPARTMENTATION, FORMAL ORGANISATION STRUCTURE, INFORMAL ORGANISATION

DEPARTMENTATION

Meaning

Departmentation is concerned with grouping the various activities into separate administrative units. It implies grouping activities and employees into departments. Departmentation may thus be defined as "the process of grouping activities into units with a view to ensuring effective management". Growth of the enterprise as well as the principle of specialisation is the genesis of departmentation. Span of management is a factor greatly restricting size of the enterprise and through departmentation only any organisation can expand to a reasonable degree. In the same way, principle of specialisation requires grouping of similar activities into separate units.

The process of departmentation takes place at all levels in the organisation. It may be noticed that the chief executive groups activities into major divisions administered by senior executives reporting directly to him. The sales manager, on the other hand, may further divide his activities in relation to different products sold, area or customer served or on the basis of activities like advertising, marketing research, customer service and so on. Thus, the common process of grouping tasks into individual jobs, grouping jobs into administrative units and grouping units into larger units to establish the departments is carried on in the whole process of the organisation. In terms of the level at which it is done the process of departmentation may be divided into the following three stages:

1. *Primary departmentation,* i.e., initial break-up of functions into basic activities.
2. *Intermediate departmentation,* i.e., creating departments in the middle levels of the organisation.
3. *Ultimate departmentation,* i.e., dividing activities into separate units at the lower levels.

Patterns used in Departmentation

Several patterns of departmentation are prevalent in the business world. The most common patterns are grouping by functions, products, territories, processes, customers, or by time. Departmentation by simple number was an important method in the organisation of tribes and armies. But in the modern society it has lost much of its ground. Labour being more skilled, specialisation has become the common basis for work division, and groups based on teamwork are found to be more efficient than those based on numbers alone. Another important reason for declining popularity of grouping on the basis of simple numbers is that it is mainly useful at the bottom level of the organisation structure or in situations where sheer number is important.

Departmentation by Functions

With the growing complexity of administration, departmentation by function has

become widely accepted and increasingly popular. It refers to grouping activities of the enterprise into major functional departments. The basic functions of the enterprise are usually classified under production, selling and financing. These are the three functions found in almost all business enterprises. But very often these terms do not appear in the organisation chart. Absence of generally accepted terminology and variation in the degree of importance of different functions may be attributed to this cause. Thus, in a concern engaged in distribution of goods, production function is normally replaced with "buying" function. Similarly, hospitals and other such organisations have no selling department.

Departmentation by functions, e.g., production, selling, finance, etc., is the most widely used basis for grouping activities into administrative units and found in almost every business enterprise at some level or the other. The other commonly recognised functions requiring separate grouping are buying, accounting, personnel and research. Which functional departments are major normally depend on the activities fundamental to any enterprise.

Departmentation by function may further be classified into the following categories:

(1) *Minor Functional Departments:* Under this, we group those activities which, though important to the enterprise nevertheless lack the supremacy of major departments. What may be major in one enterprise or at one time may be minor in another organisation or at another time.

(2) *Major Functional Departments:* Departments which carry on basic activities of the enterprise are known as major functional departments. In every enterprise, services offered are often divided between major departments. If major departments covering any of these activities are not organised, it may mean that the state of the market does not require the exertion of maximum effort.

(3) *Derivative Functional Departments:* These are created when the manager of any functional division feels that his span of management is too broad. With the expansion of activities it may be necessary to divide the buying function and appoint a purchasing agent. The new purchasing unit is a derivative functional department, it would appear on the organisation chart at the second level.

Departmentation by enterprise functions is illustrated in Figure 1 on page 290.

Advantages of Departmentation by Functions

A number of advantages are claimed for functional departmentation. Firstly, functional departmentation represents a very natural and logical way of grouping different activities of the enterprise. Production, selling and financing represent a very natural classification of enterprise functions. Another benefit of such grouping is specialisation. By concentrating on similar activities in the respective departments specialised knowledge and skill are acquired which can be utilised for efficient running of the departments. This leads to economy in operation and efficiency in the use of manpower and other resources.

The next important advantage of functional departmentation is that it facilitates co-ordination within the function. It is easier for the manager incharge of a particular function to synchronise activities and unify efforts of personnel engaged in that

particular function and to co-ordinate activities pertaining to different functions. Functional departmentation is devised to direct adequate attention to the basic activities of the enterprise. It also guarantees the availability and effective utilisation of outstanding abilities of a few individuals in the organisation to the enterprise as a whole. This is possible because those few individuals are supposed to occupy the top positions in the organisation for controlling groups or functions. Lastly, functional departmentation is a time-proved method that can easily be justified by the management.

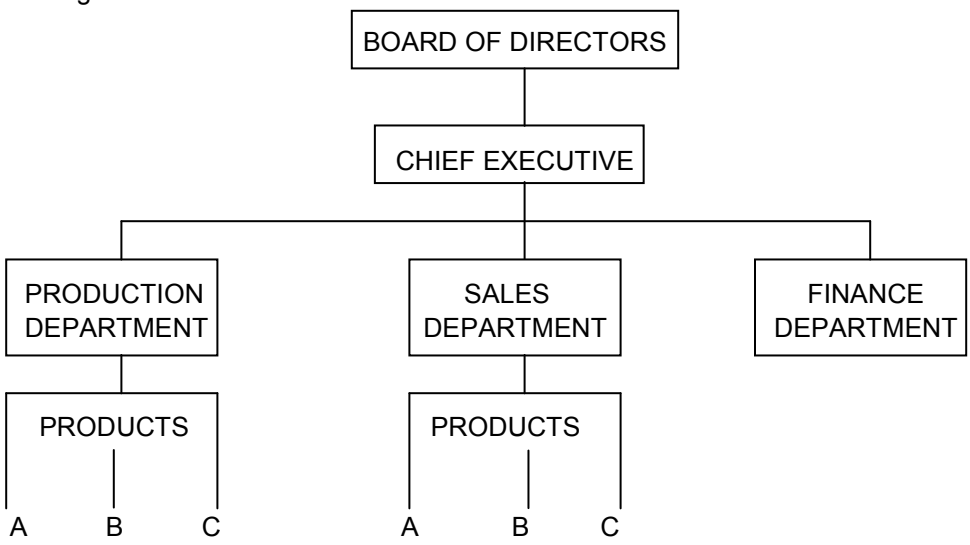


Figure 1: Functional Departmentation

Disadvantages of Functional Departmentation

Functional departmentation is not without limitations. With the growth in size and diversity in activities of the enterprise, advantages of functional departmentation become its shortcomings and claims of other basis of departmentation becomes stronger. With the growth of the enterprise, centralisation tends to become excessive and thereby causes delay in decision-making and flow of information. Decision on problems covering two or more functions can only be made at the top of the organisation. But in the process of communication, decision-making and its implementation are further delayed. Besides, functional departmentation tends to make the functional executives so much conscious of their respective functional areas that the business as a whole very often remains out of the sight of those executives. This results in consumption of time in emphasising the mission of the enterprise and makes co-ordination between different functional areas more difficult. Another serious limitation of functional departmentation is that a company which is functionally organised does not offer a good training ground for all-round promotable managers. A manager supervising a particular function more often becomes an expert in handling problems of that particular function alone.

Where the enterprise has outgrown the original functional departmentation, management must decide to adopt some other basis of departmentation. At what point change should be effected is difficult to say. But it is desirable that the manager

should undertake a thorough analysis before making any final decision on the problem. Diversification of production according to buyer classifications may call for emphasising departmentation on product basis.

Departmentation by Product or Services

When activities associated with each product or group of closely related products are combined into relatively autonomous and integrated units within the overall framework of the company, such an organisation is described as product departmentation. Under this arrangement, an executive is put in charge of all the activities relating to a product or product line and enjoys extensive authority over production, sales, development, service and other functions pertaining to that particular product. Place of location of product unit is irrelevant here. Product departmentation is illustrated in Figure 2.

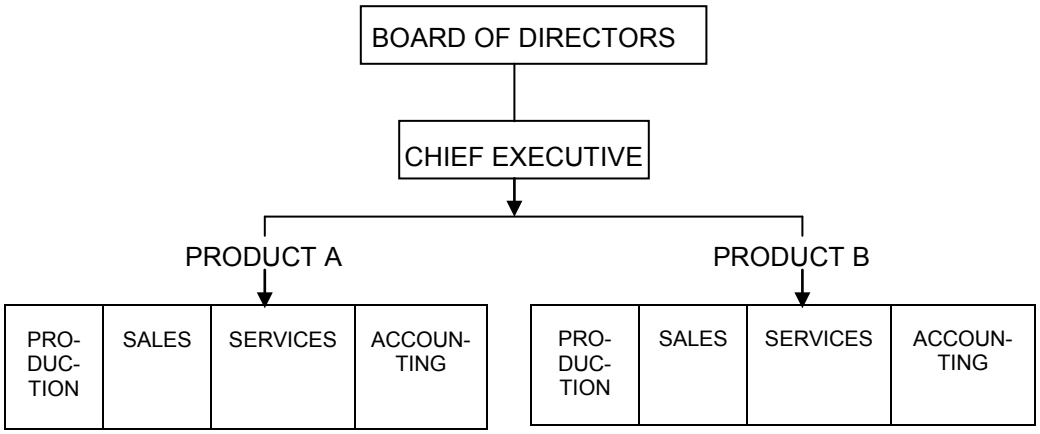


Figure 2: Product Departmentation

Product departmentation enjoys the advantage of specialised product knowledge and promotes co-ordination of different activities connected with a particular product. Since responsibility for the result of each product is fixed, the executive who is in charge of the product is motivated for expansion, improvement and diversification of the product. However, such an arrangement can at times lead to difficulties in co-ordination. Manager of a product who has been successful in running his department may well be prompted to acquire more power for himself and on an extreme may desire to disintegrate from the overall organisation.

Grouping by Locations or Territories

When activities of the enterprise are physically or geographically dispersed, provision for local administration is desirable and at times necessary in the interest of efficiency and economy in operation. Such an organisation is viewed as territorial departmentation. Sometimes delay in communication is cited as a good reason for territorial departmentation. But with tremendous improvement in the means of communication, this factor has lost much of its weightage as a factor favouring geographic territorial departmentation. Koontz & O'Donnell have mentioned two valid reasons favouring territorial departmentation:

(a) to avoid close-chambered view, i.e., to make the managers not to ignore

local factors in decision-making; and

(b) to take advantage of certain economies of localised operation.

It may be mentioned that grouping by locations signifies adaptation to local needs and facilitates prompt actions. In addition, when an executive is made in charge of a particular area it can be expected that activities within the scope of his area or authority will be more effectively co-ordinated and controlled. Departmentation on the basis of location also offers opportunity to the top management to allow employees to gain experience with minimum of risks to the firm.

Departmentation by Time

Most of us are familiar with the "second shift" or the "right shift" concept. When operations extend far beyond the normal work period of an individual it may well be spread over a certain shifts. Such a grouping is frequently termed as departmentation by time. Enterprises engaged in continuous processes e.g., public utilities, restaurants and many others departmentalise by time as a normal arrangement. Units so created on time basis perform similar operations. The important organisational problems to be decided here are clustered round the extent to which each shift shall be self-contained and the kind of relationship that should exist between specialised activities working only normal times and others discharging their duties during extra hours. Grouping by time is more common with production function of the enterprise.

Grouping by Process and Equipment

Activities may also be grouped into different departments on the basis of process involved or equipment used. Such a grouping is usually resorted to in a manufacturing concern. Thus, a cotton textile unit may have separate units for spinning, weaving, dyeing, inspection and shipping. Better supervision, optimal use of equipments, specialisation and avoidance of investment in duplicate are the important benefits of such departmentation.

Grouping by Customers

Departmentation by customers is more popular in sales activities of the enterprise. This pattern is usually followed when paramount interest is required to be shown in the welfare and interest of the customers. Thus, the wholesaler selling goods in retail normally divides his activities into separate units catering to retailers and customers respectively. Similarly, educational institutions offering regular and extension courses to cater to the requirements of various clearly defined customer groups are instances in points. Customers may also be classified on the basis of age (child, adult) sex, income, taste, attention etc., or into such categories as industrial/ institutional and individual customers etc.

Customer departmentation assures full attention to different customer groups. It helps enhance company's image and goodwill. Since customers are divided into identifiable groups, the pattern permits use of specialised knowledge for each of such groups. Since marketing may be described as the raison-d'etre enterprises existence and customers as its bread and butter, one witnesses several organisational innovations in this type of departmentation. For example, departmentation around marketing channels and marketing-centering organisation are aimed at harnessing the benefits of competitive edge won through customer satisfaction.

Marketing Channel Departmentation: It is a new basis of departmentation. The enterprise is organised around channels of distribution. It is not uncommon for the

same product to be marketed through widely different marketing channels. The essential consideration is the marketing channel used.

In the era of super competition, marketing considerations would be dominant in setting up an organisation structure where these fit with product or territorial departmentation, much more than traditional forms. This kind of organisation has grown in importance as businesses have become increasingly market-oriented.

Temporary Departmentation: It may be:

(a) *Temporary product division:* It is identical with product departmentation except that it has a predetermined life time. The employees in these divisions are deprived of all the fringe benefits enjoyed by the permanent cadre.

(b) *Task force:* It is temporary organisation whose objective is to investigate and recommend a solution for a problem or a proposal. A group with appropriate expertise is assembled to solve the problem as a joint effort. All members of the force are selected for their expertise, they typically report administratively to their regular managers. It is a good approach to find solution of problems beyond the power of one manager to solve. But the task force manager is seldom given administrative authority over the team members and may encounter difficulty in getting their active cooperation to accomplish a task on schedule.

Principles of Departmentation

The problem pertaining to pattern of grouping activities of any enterprise cannot be resolved just by deciding in favour of a particular type and negating the others. In fact, few organisations are following exclusively a particular pattern of departmentation. Every pattern of departmentation yields certain advantages. The judicious approach is, therefore, to devise a composite departmentation even though the organisation may dominantly be structured on one of the many bases of departmentation discussed above. In other words, the different bases of grouping the activities provide only the general guidelines. The manager must consider the advantages and disadvantages of each method of departmentation along with the basic factors involved in grouping activities of the enterprise. And after such evaluation only one should determine the kind of composite departmental structure best suited to the requirements of the organisation.

One of the basic factors to be considered in grouping activities is that of specialisation. The organisation structure should divide and group the activities of the concern in such a way that similar and allied activities are put under one department. Specialisation leads to more and better work with the same effort.

Further, departmentation should be such as to facilitate control. Activities are not grouped with intent to weaken control. If objectives are to be accomplished effectively, departmentation should not only facilitate control but also help in co-ordination. Departmentation should also allow adequate attention to be paid to each of the functions of the enterprise so that different activities are properly balanced. Nevertheless, departmentation should, as far as possible, avoid duplication of sections. In addition, departmentation should not overlook human side of the organisation. Impact of the structure upon human factor should be given due consideration while departmentalising activities of the enterprise. Activities should also be grouped in the manner that will best contribute to achieving enterprise objectives and reduce its cost. Lastly, pattern of grouping should be avoided in a way

so that local conditions are given due recognition.

FORMAL ORGANISATION STRUCTURE

The formal organisation refers to the structure of jobs and positions with defined functions and relationship. This type of organisation is built by the management to realize the objectives of an enterprise.

The types of organisation employed by companies vary considerably. However, on the basis of the nature of authority and its flow, the fundamental organisation structures may be classified as follows:

(1) Line Organisation, (2) Functional Organisation, (3) Line and Staff Organisation, (4) Project Management Organisation, (5) Matrix Organisation.

1. Line Organisation

Historically, line type of structure is the oldest pattern of organisation. It is indispensable to all organised efforts and provides channels of upward and downward communication. It is simple and the most direct type of organisation. Here authority flows directly from the top of the organisation down to the lower echelons of management hierarchy. Each position in the organisation structure enjoys general authority. This type of organisation is simple and makes no provision for staff specialists. Whereas authority flows downward, accountability in the line organisation flows upward. Scalar principle and principle of unity of command are strictly followed in this type of organisation.

The line organisation is illustrated by Figure 3 given below:

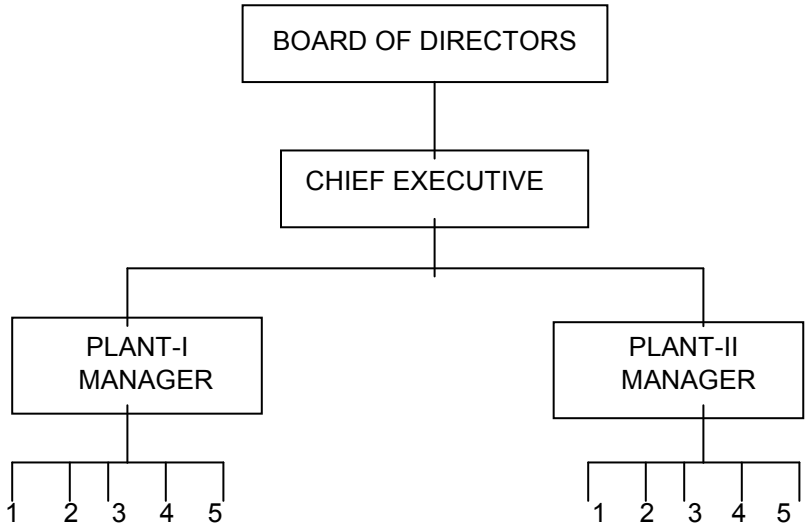


Figure 3: Pure Line Organisation

Benefits of Line Organisation

1. It is simple to work. There are no nebulous staff positions to confuse the subordinate managers.
2. It is economical and effective. It permits rapid decisions and effective co-

ordination.

3. It promotes unity of command and conforms to the scalar principle of organisation.
4. It fixes responsibility for the performance of tasks in a definite manner upon definite individuals.
5. With a unified control and undivided loyalty, line organisation ensures excellent discipline.
6. It is less expensive due to non-involvement of staff personnel.
7. It is stable.

Weaknesses of Line Organisation

1. It suffers from lack of specialisation. Each department manager is to look after activities of his own department only.
2. There is possibility of key men being loaded to the breaking point. Since there is no staff aid, the organisation can be seized by a strong man and run on an arbitrary basis. Such a dictatorial or arbitrary power can lead to considerable damage to the organisation. If top leaders occupy unquestioned authority, even though they may be executives of rare competence, there is further risk to the growth of the company if something goes wrong with them particularly in the absence of provision to train, develop, or replace the top leaders. Thus, the loss of one or two key men may cripple the entire organisation.
3. Such enterprises suffer from lack of expert staff advice. There are occasions when line manager is not competent to make decisions. But line organisation has the effect of compelling the manager to make decisions irrespective of his ability or competence to do so.
4. Line organisation is rigid and inflexible. Discipline is maintained to the extent that organisation is rarely allowed to change.
5. It is based upon an autocratic system of management.
6. The work may be divided according to the whims of the manager rather than according to any scientific plan.
7. It cramps progress and prevents effective working of the unit.
8. It is likely to encourage nepotism.

The system can be successfully utilised:

(i) where the scale of business is small, number of subordinates and operative employees are not many;

(ii) in continuous process industries;

(iii) where the work is largely of routine nature;

(iv) where the machinery is nearly automatic and does not call for the intelligence of the foreman;

(v) where labour-management problems are not difficult to solve.

2. Functional Organisation

Under this system, the whole task of management and direction of subordinates is divided according to the type of work involved. At the higher levels, the functional organisation refers to the structure that is formed by grouping all the work into major functional departments. Related and similar work is done in one department under one executive. For example, the purchaser is responsible for all purchases of the company. The scope of the work is limited but the area of authority is unlimited.

F.W. Taylor recommended functionalisation even at the shop level. Instead of putting the workers under the foreman, Taylor suggested the scheme of functional Foremanship. Under this scheme, the operator is under as many as eight foremen, four belonging to the stop work and four to the office work. The foremen to operate at the office level are:

(i) *Time and Cost Clerk* – to lay down standard time for completion of the work and carry out cost calculations in respect of the work.

(ii) *Instruction Card Clerk* – to lay down the exact method of doing the work.

(iii) *Route Card Clerk* – to lay down the route through which the productive process shall pass to completion.

(iv) *Disciplinarian* – to deal with cases of indiscipline and absenteeism.

Functional Foreman at the Shop Level

(i) *Gang Boss* – to assemble and set up machines and tools for a particular job.

(ii) *Speed Boss* – to determine appropriate speed to run the machine.

(iii) *Repair Boss* – foreman responsible for keeping the machines and equipment in working order.

(iv) *Inspector* – to check quality of the work done.

Taylor's functional foremanship is illustrated by Figure 4.

Taylor's functional foremanship is seldom found in practice. But functional organisation in the sense of staff experts enjoying functional authority relating to their respective areas of speciality over lower line managers is quite popular.

The chief advantage of functional system is that it ensures division of labour and specialisation based on individual proficiency and specialised knowledge. This makes for better utilisation of employees and development of their skills. The disadvantage of one-man control under line organisation is largely alleviated here. Functional foremanship through separation of mental and manual functions also facilitates mass production through specialisation and standardisation. People in different departments have to perform limited number of functions and this leads to economy of operations and high degree of efficiency.

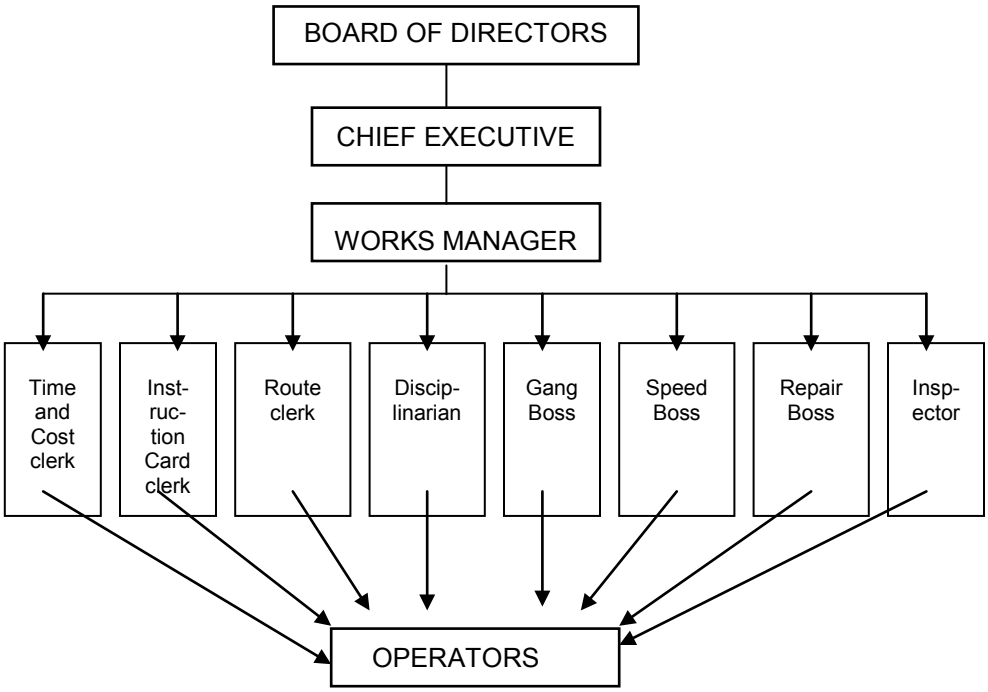


Figure 4: Functional Foremanship

Drawbacks of Functional Organisation

(i) Because of high degree of specialisation, functional organisation is difficult to establish.

(ii) Changes in personnel often lead to instability since performance also shifts with these changes.

(iii) Specialists often operate with considerable independence so that the organisation seldom functions as a total system. As a result, control and co-ordination becomes difficult to achieve.

(iv) Authority and responsibility often overlap and good deal of friction results; locating and fixing up responsibility becomes extremely difficult.

(v) Specialists usually ignore the big picture so that a deficiency of leadership is almost perennially felt.

3. Line and Staff Organisation

Both the line and functional plans prove inadequate in operation. The line system concentrates on authority too much. But purely functional plan also divides it too much. The line and staff system strikes a happy balance between the two.

Under this organisation “line” is supplemented by “staff”. The staff refers to officers who are not line managers but are more or less permanently detailed to special services or to the study of some phases of operations. Staff personnel thus act as an advisory group adjacent to the line.

This pattern of organisation came into being as a result of the departmental managers having to investigate, think and plan and, at the same time, performing the ordinary tasks of production and selling. Consequently, the work of investigation, research, recording, standardisation and advising, i.e., the work of experts, was wholly distinguished and separated from the routine process of manufacturing and selling. Thus, there arose a clear demarcation between 'thinking' and 'doing'; the staff being the 'thinkers' and the line being the 'doers'.

Line and staff organisation is illustrated by Figure 5 given below:

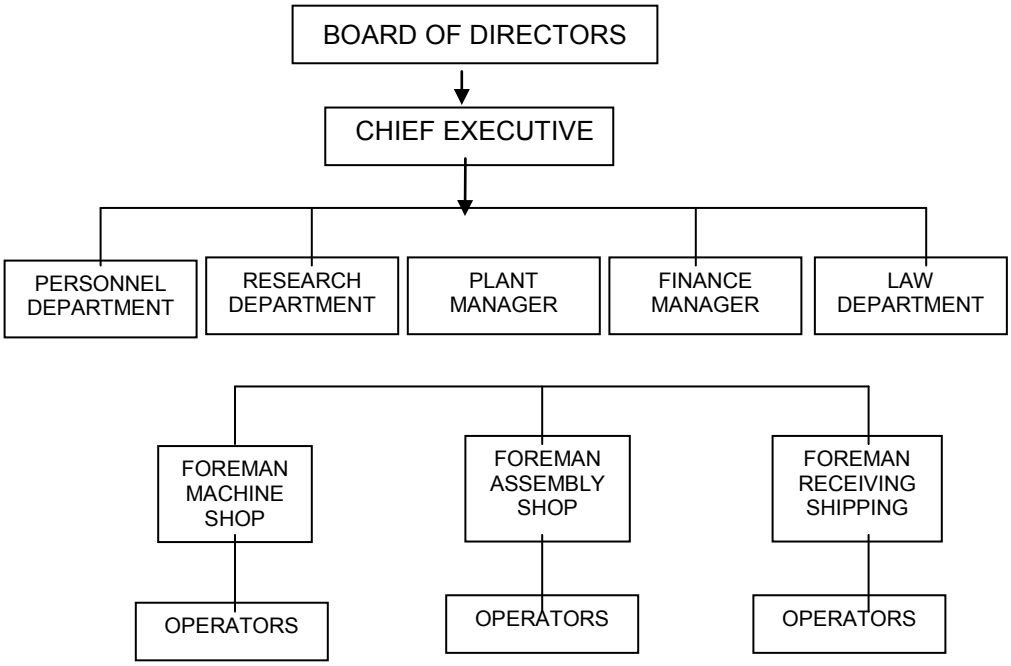


Figure 5: Simple Line and Staff Organisation

The merits of line and staff organisation are:

(i) It adds functional specialists to the pure line organisation and thus aims at combining the merits of the two.

(ii) The stability and discipline of the line organisation are preserved; only the specialist is added.

(iii) It brings expert knowledge to bear upon management. Functional specialists provide advice to the management on wide-ranging matters.

(iv) It provides for better placement and utilisation of personnel and leads to more concerted skill development.

The drawbacks are:

(i) The line and staff relationships often lead to numerous frictions and jealousies.

(ii) Line managers may depend too much on staff experts and thus lose much of their judgement and initiative.

(iii) On the contrary, the staff experts remain ineffective because they do not get the authority to implement their recommendation.

The Problem of Choice:

The problem of choosing from among the three types of organisation discussed above is not that of selecting one of them; rather it is concerned with determining the right balance among the three. The line structure is part of every organisation, no matter how small or simple it is. The line structure is characterised by total absence of staff specialists. At the other extreme is functional organisation with too much of specialisation. In between these two lies the line and staff organisation. However, purely advisory character of staff positions is hardly maintained in actual practice. In that case violation of the principle of unity of command to some extent becomes inevitable. Line organisation in its pure form is rare except in small undertakings or in units with repetitive processes. Functional structure with all the specialists having complete functional authority over different lower line managers is also a rare possibility. With the growth of the enterprise and added complexities, line structure of organisation tends to be modified by addition of certain staff positions in the organisation. But absolute advisory character of all the staff specialists is rarely maintained in actual practice. A typical organisation is generally characterised by line and staff positions in structure with some of the staff specialists vested with a degree of functional authority relating to their respective areas of specialisation over lower line managers. Some of the staff managers generally succeed in acquiring a degree of functional authority whether permitted or not. It would be judicious, therefore, to strike a balance between the line and functional authority.

Line and Staff Authority Relationships:

The problem of line and staff is concerned with deciding about the kind of authority to be allocated and the nature of authority relations to be established in the organisation. In spite of much confusion about these two concepts, line and staff relationships are important for proper understanding of the organisation. An enterprise is organised for some specific purpose or purposes and line functions are commonly described as those which have direct responsibility for accomplishing enterprise objectives. In terms of functions, production and sales are commonly classified as line functions. Line is then identified by the objectives of the company. However, it may be mentioned that functions which are termed as line in one company may not be so in the other company and that all depends on the importance of the activities and the nature of business of the organisation.

All those components of the organisation which are not line are then staff elements. Staff is commonly described as referring to those elements of the organisation that help the line to work most effectively in accomplishing enterprise goals. Thus, staff is concerned with providing advice and service to the line, and the department whose primary job is to render service and advice to other departments is described as staff department. One can observe a chain of command within the staff department also.

Another useful way of understanding line and staff concept is to view them

through authority relationship. Line authority obeys the scalar principle and falls in the direct line of command. Thus, line authority runs from the top to the bottom through superior-subordinate relations in the organisation. Line authority is found in all organisations irrespective of differences in the nature of activity and scale of operations. Staff authority is described as advisory. J.D. Mooney has described staff authority as auxiliary functions but "adhering to the line like sidings along the main track". Thus, staff function exists in relation to some line function and not independent of it.

Urwick has pointed out the limitations of describing staff as purely advisory in nature particularly when applied to the general staff. The staff in real life does much more than merely advising the line. His additional activities are:

(i) framing procedures, regulations and sometimes policies to be issued to line personnel in the name of some top line superior;

(ii) interpreting plans and "selling" them to line personnel;

(iii) rendering help to line superiors and their subordinates by supplying them adequate information on the working of plans; and

(iv) reporting to superiors on the extent of compliance by line subordinates with staff advice.

Thus, through the top line seniors, the staff exerts lot of influence on lower line subordinates. Within his department also staff in charge operates in the line capacity. The staff may also enjoy certain functional line authority for a part of his work. It is then clear that describing staff as purely advisory in capacity would only add to the discrepancy between his prescribed authority and his real influence and power due to expert knowledge and position in the structure. Douglas McGregor has also mentioned the sinister possibility of line using his staff to spy on and police his subordinates as a cover to hide his inefficiency in developing proper human relations in the organisation.

Some people distinguish line and staff relations on the basis of division of managerial functions. To act is described as line manager's prerogative whereas staff function is to think. F.W. Taylor also favoured separation of thinking and planning from doing. However, management represents the sum total of planning, organising, staffing, directing and controlling. Complete segregation of management into thinking and doing is neither desirable nor feasible. Similarly, some people tend to regard line and staff authority as type of departments. Some departments like service, public relations and personnel management stand predominantly in staff relations to other departments. In the same way, departments are by and large line in character. However, departmentation represents grouping of activities into units for the purpose of administration. Departmentation is not based on authority relationships which is the primary characteristic of line and staff authority components. Thus, line and staff are distinguished by their authority relationships and not by departmentation or grouping of activities.

Line and Staff Concepts Criticised:

The behaviouralists point out how staff people, originally conceived of as helping the line personnel, tend to be regarded as source of interference than a source of help. The classical theory of line and staff is also attacked by Simon. He points out

that divesting the staff of authority over the line in the interest of observing the principle of unity of command is contrary to the principle of specialisation applied to the process of decision-making. Staff specialists who are most competent to make decisions relating to their respective areas of speciality are deprived of the opportunity to do so. There are also those who suggest that line-staff concept is obsolete, and have questioned the wisdom of, what they call, slavish adherence to the line-staff concept.

However, line and staff are useful concepts and their proper understanding greatly contributes to organisational effectiveness. The manager must know his position in the chain of superior-subordinate relations and be clear whether he is to advise or command.

Kinds of Staff

Staff positions may be divided into two categories:

Personal Staff: Personal staff is created with the primary object of assisting the manager in doing those parts of his job for which he lacks inclination to delegate or cannot delegate. These matters include planning, policy-making, co-ordination, control and human relations.

Personal staff may further be sub-divided into line assistants, staff assistants and general staff assistants.

(i) *Line assistant*: A line assistant is staff to his superior and advises on acts for him. Since he has no authority independent of his principal, he cannot redelegate his authority.

(ii) *Staff assistant*: He is usually described as “assistant to” and enjoys no authority over other employees. It is only when a task is specifically assigned to him, he acquires limited authority. His usual function is to open the mail, reply to the telephone or speak on behalf of his principal.

(iii) *General staff assistants:* General staff assistants are used in addition to specialised staff, and usually serve as advisors to top management in certain specified areas.

Specialised Staff: Specialised staff operates on functional basis, serves and advises all the line and other staff departments in their specialised functional area. Thus, personnel manager as specialised staff helps all other departments in the organisation on personnel matters. Specialised staff occupies line authority within his department but enjoy no authority over other parts of the organisation. Secondly, specialised staff is available for use by all other line or staff departments in the organisation. But his advice is confined to the specified function or activity in which he is specialised and entrusted with.

Conflict between Line and Staff:

Ideally, line and staff should work together in harmony and as an integrated team. But, more frequently line and staff relations become a potent source of friction, inefficiency and organisational ill health. Rivalry between them very often takes the form of animosity. Both line and staff have their own viewpoints to offer relating to this problem.

The Line Viewpoint:

(i) Staff undermines line authority.

(ii) Staff thinks in vacuum.

(iii) Staff steals credit.

(iv) Staff fails to give sound advice.

(v) Staff fails to keep the line informed.

Line personnel enjoy authority to command and act to achieve enterprise goals. Staff is expected to give advice. Failure to recognise this and frequent encroachment by staff over line authority and prerogative become the cause of friction. It may also be witnessed that staff operates within the limited area of his expertise and fails to see the business as a whole. It is said that the staff is so conscious of his area of specialisation that he fails to relate his actions to the total organisation and overall objectives of the enterprise. In addition, line personnel frequently complain that when a programme is successfully implemented, staff tends to assume credit for its success, but blame the line in case of failure. Thus, line and staff authority relations provide an ideal case for shifting of blame. The operating executives also criticise the staff on the ground that the later does not give sound advice. Staff is condemned as unrealistic or too much theoretical. Use of technical jargon, proposing new ideas without thorough study or testing them, and failure to enlist support of line executives to new ideas are the important factors giving rise to this attitude on the part of the line. Next, when staff manager works with the line manager's subordinates without informing him, manager is likely to feel against the staff.

The Staff viewpoint:

The staff is equally critical of the line executives. Their main say centres round:

(i) Lack of authority to command line subordinates,

(ii) Resistance to change by the line,

(iii) Inability to make proper use of staff.

Allured by the special skill and ability in a particular field, the staff is tempted to think that the solution to the problem recommended by him is best and needs be enforced on the line manager. Line is also charged with being short-sighted and resistant to change. Staff people further complain that line executive does not make maximum and proper use of the staff either because he is afraid of interference or fails to appreciate the help and advice offered by the staff. In either case staff is rendered ineffective and conflict is likely to arise.

Other Reasons of Conflict: However, some other reasons may also be attributed to the growing conflict between line and staff.

Line and staff authority relationship cannot substitute for poor selection of line or staff personnel. Thus, incompetent staff cannot evoke confidence whereas inefficient line executive cannot take full advantage of even valuable staff suggestions. In the same way, due to management or organisational complications when staff personnel are vested with some functional authority, conflict in instructions arising on account of violation of the principle of unity of command is likely to prove a potential source of strife. Ambiguity in authority delegation and lack of clarity in defining line and staff relationships in the organisation provide yet another source of misunderstanding and dissension.

How to Minimise the Conflict?

Line and staff are a matter of authority relationship having a direct bearing upon the organisational health. If in a company line and staff work as an integrated team, organisational efficiency and effectiveness are bound to improve. But even under the best of circumstances, possibility of conflict cannot altogether be eliminated since co-operation cannot be forced; rather people need to be persuaded to co-operate. However, the following suggestions may be helpful in this connection:

(1) Line and staff should understand their proper position in the organisation. Staff should know that advising the line is their exclusive function. Similarly, line executive enjoys authority to command and is directly responsible for accomplishing enterprise objectives. Thus, proper understanding of their respective role and relationships in the organisation structure will go a long way to minimise the conflict between the line and staff.

(2) Line should be educated and encouraged to use staff effectively.

(3) Staff should realise that resistance to change is partly natural. They should, therefore, work for overcoming resistance to change. Staff should work on the assumption that it has to "sell" new ideas. Line executive should be encouraged to participate in the proposed scheme of change.

(4) Staff should realise that it commands respect and reputation in the organisation due to its skill and expert knowledge in a particular field. Thus, staff should constantly strive to acquire and increase its proficiency.

(5) Staff should render complete advice on the problem concerned. They should present realistic recommendations and solution based on full consideration of all the pertinent facts.

4. Project Management Organisation

Project management is not a new concept. It represents an outgrowth of committee and the task force organisation. Assignment of a new project to a group of persons best qualified for its completion is quite common in the defence services.

Nature and Scope of Project Organisation: Project organisation is not a separate type of organisation like the line, line and staff or functional organisation; rather it is set up within an existing organisation for the purpose of completing a project or accomplishing assigned objectives in time and within cost and profit goals as laid down by the management in this connection. Project organisation is directed by the project manager responsible for project goals.

Project management is generally applied to new areas of development or to those areas which call for prompt decisions. It can be usefully applied to one-time undertakings with the following features:

(i) *Definable in terms of a single and specific results.*

(ii) *Unfamiliar to the existing organisation:* An undertaking is a project only when it is unique or uncommon. A change which is familiar can be easily accomplished by management on the basis of past experience. However, unfamiliar undertaking leads to disagreement or uncertainty as to how the undertaking should be managed. This calls for special attention to be given to the unfamiliar undertaking.

(iii) *Complexity:* If the given task depends upon completion of other assignments in other functional areas, project organisation is required. Thus, introduction of a new product brings complexity through its interdependence on other tasks like sales promotion, product availability and tools availability etc. Hence project organisation is called for.

(iv) *Stake involved:* The final criterion for applying project organisation concept is that the project is critical to the company because of its impact upon reputation of the company, costs in terms of money involved, importance or time objective.

Project management organisation may involve development and introduction of a new product, complete redesigning of an existing product line, installing a new plant, and the like.

Project organisation involves appointment of the project manager usually drawn from the middle management ranks and having responsibility for detailed planning, coordination, control and achievement of the result within the time schedule. Project manager operates with a team of qualified personnel drawn from different functional departments involved in the project. Moreover, project manager's authority is functional within the limits of the project. Another important characteristic of project organisation is its dissolution after the project work is completed.

Resulting Organisation Structure: The essence of project management organisation is its independent status which cuts horizontally the normal organisation structure. Since project management usually requires prompt decisions and actions from a number of functional areas, flow of information is largely lateral and not vertical. Thus project organisation is characterised by exceptionally strong horizontal working relationships. For instance, major product development calls for close working between the engineering, production and marketing departments; and at the same level in organisation hierarchy. However, frequent product changes and decisions affecting costs require communication with the superiors. Project organisation, as such does not completely rule out the possibility of vertical communication though horizontal working relationships are more strong. To be more effective, the project manager should occupy the same status in organisational hierarchy as is occupied by managers of the functional departments. This may be illustrated in the project organisation chart produced at page 305.

Contributions of Project Organisation: Project organisation is largely the outcome of the limitations of traditional functional organisation. Project organisation counteracts the functional weakness and helps in successful completion of the project. Following are its important contributions:

(1) It provides for concentrated management attention.

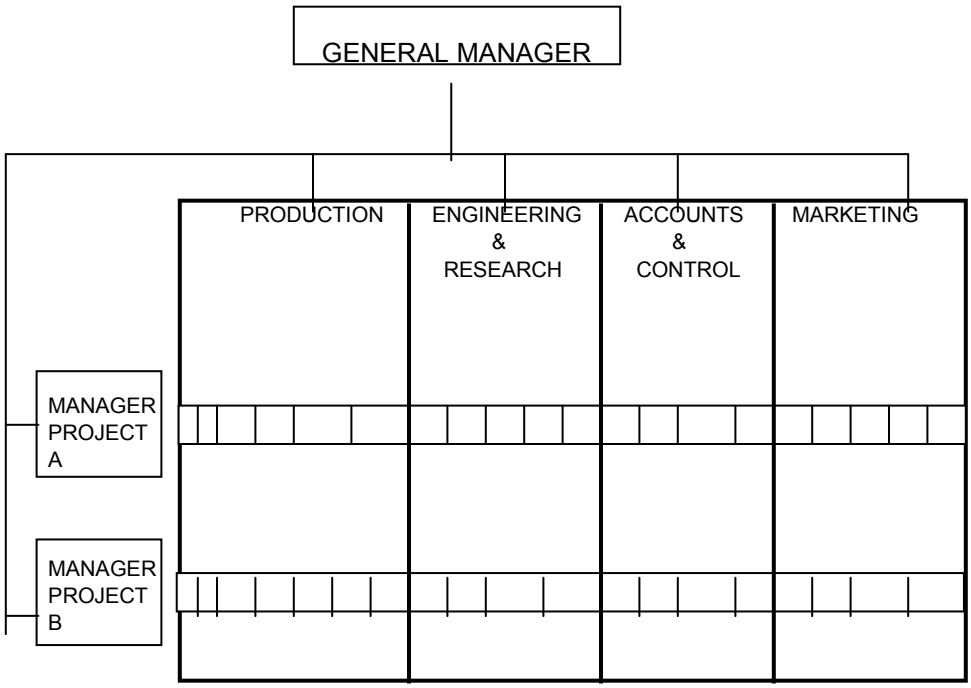


Figure 6: Project Organisation.

(2) It facilitates unified approach and prompt decision relating to the project and inculcates flexibility in management.

(3) It ensures on-time and on-budget completion of the project.

(4) It allows other parts of the organisation to proceed normally while the project is underway.

As against these advantages there are certain drawbacks of project organisation. Thus, project organisation involves temporary shifts of responsibility and reporting relationships. In consequence, normal working of the regular organisation is jeopardised. There is yet another problem relating to this aspect of project organisation. After its successful completion, the project manager and his team return to their permanent assignments. By the time project is completed, the project manager may find himself more mature and fit for a more responsible assignment than permitted by his routine job. This situation is likely to make the project manager feel uneasy and disturbed. In addition, project organisation assumes unusually disciplined executive efforts which may not always be forthcoming.

Types of Project Organisation:

(1) *Individual Project Organisation:* It is characterised by one person (project manager) controlling the project through functional departments performing all the work.

(2) *Staff Project Organisation:* Here the project manager is assisted by the staff

in matter of exercising control through scheduling, change, control, and the like.

(3) *Intermix Project Organisation:* In this type of project organisation, some of the primary functions from the functional departments are put under the control of project manager along with the staff functions.

(4) *Aggregate Project Organisation:* Here, departments and activities required to accomplish a project are made to report directly to the project manager.

5. Matrix Organisation

A newly evolving organisation structure which has received considerable attention in the West is the Matrix Organisation. It combines functional departmentation with product or project organisation. In a matrix organisation, the functional departments like manufacturing, marketing, accounting and personnel constitute the vertical chains of command while the project organisation or product divisions form the horizontal chains of command. The vertical lines of authority are cut horizontally across by project or product line divisions. The matrix or task force consists of a group of individuals drawn from the various functional departments who are assigned to particular projects or product divisions and are considered best qualified for the work. The project manager or divisional manager usually reports to the Chief Executive in a line capacity (See Figure 7).

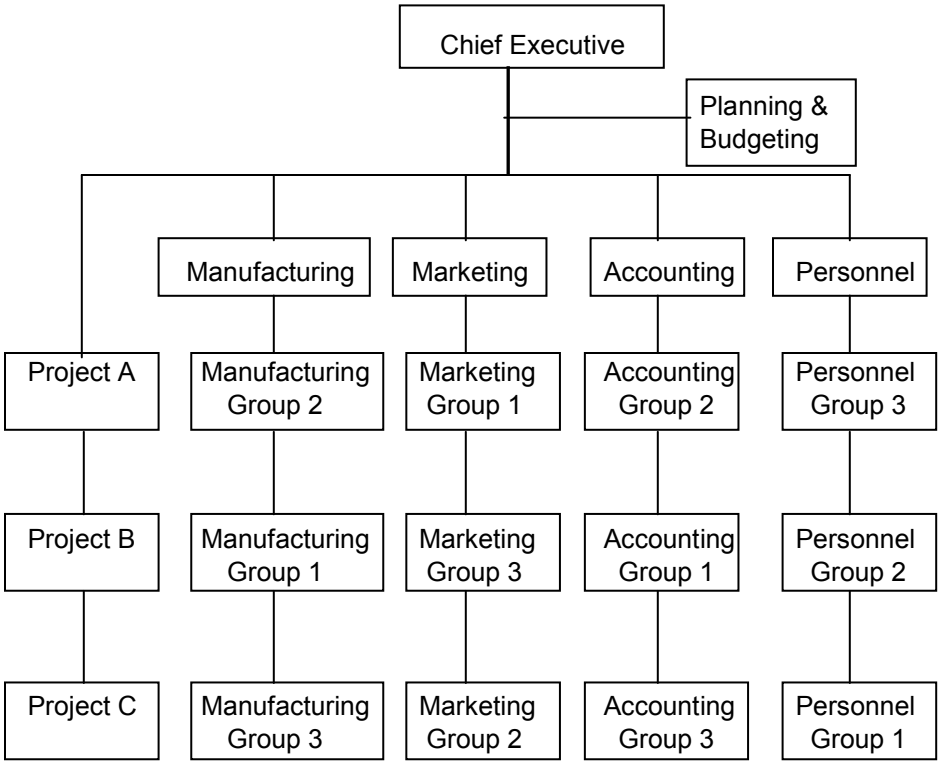


Figure 7: Matrix Organisation.

The matrix organisation structure is designed to derive the benefits of both functional structure and the divisional structure. It helps to promote specialisation as well as lateral co-ordination and highlights the achievement of business results in each of the divisions and the organisation as a whole. However, it suffers from several limitations. The multiplicity of vertical and horizontal relationships impair organisational efficiency. The secondment of specialists from functional departments to a number of projects makes it difficult for functional heads to appraise employee performance. Disagreement between project teams and functional departments result in considerable stress for the personnel.

INFORMAL ORGANISATION

Meaning

Informal organisation is an important concept in the study of organisation. People in the formal organisation have a tendency to cut across formal channels and communicate informally with other parts of the organisation. Formation of groups, cliques or sub-cliques is all pervasive. People tend to be motivated by group norms, social conventions and leaders enjoying no formal authority. Thus, there exists a more complex and complicated system of informal relationship along with the formal relations in the organisation. Such informal relations are not portrayed in the organisation charts and manuals.

Barnard viewed informal organisation as joint personal activity without conscious joint purpose, even though possibly contributing to joint results. Keith Davis regards informal organisation as the network of personal and social relationships which is not established or required by formal organisation. Thus informal organisation comprises the whole set of customs, social norms and ideas by which people are influenced.

Informal organisation refers to the relationship between people based not on procedures but on personal attitudes, prejudices, likes and dislikes. There always exist informal organisation in a formal organisation and every management has to recognise this fact.

Informal organisation is characterised by the following features:

(1) It develops spontaneously and is not established by formal managers.

(2) It is based on informal authority attached to the person and not the position. Informal authority is earned and not delegated. This authority under informal organisation largely flows upward or horizontally.

(3) Informal organisation represents human tendency to cut across formal channels and communication informally with other parts of the enterprise.

(4) People in the informal organisation are influenced by leaders without any formal authority.

(5) It is all-pervasive and exists in every enterprise.

(6) Informal organisation is not always destructive though at times it can make the job of management more difficult. Because of its powerful influence on productivity and job satisfaction, formal management will do well to derive benefit from the study of informal organisation.

(7) Informal organisation cannot altogether be abolished. Informal organisation is not created at the will of the formal managers, nor the latter can do away without the social conventions and group norms.

Functions of Informal Groups

(1) These groups maintain and continue the cultural values and life style of the group.

(2) They provide social satisfactions.

(3) The group develops system of communication in order to meet wants and to keep its members informed about what affects them.

(4) They exercise social controls by which the behaviour of others is influenced and regulated.

Problems Associated with Informal Organisation

(1) *Resistance to change:* There is tendency for the group to become overly protective of its life style and to stand like a rock in the face of change. They are strongly bound by conventions, customs and culture.

(2) *Role conflict:* The quest for social satisfactions may lead members away from organisational objectives. What is good fo the employee is not always good for the organisation. That results in a role conflict. Workers want to meet the requirements of both their group and their employer, but frequently these requirements are in conflict.

(3) *Rumour:* Communication in informal organisation leads to the problem of rumour.

(4) *Conformity:* Social control of informal groups exerts strong pressures for conformity. The close they are attached to it, the stronger its influence is.

Benefits of Informal Organisation

Informal systems bring a number of benefits for employers. These are:

(1) Makes more effective the total system.

(2) Lightens work load on management.

(3) Helps get the work done.

(4) Tends to encourage cooperation.

(5) Fills in gaps in a manager's abilities.

(6) Gives satisfaction and stability to work groups.

(7) Provides a useful channel of communication.

(8) Provides a safety valve for employee emotions.

(9) Encourages managers plan and act more carefully.

Control of Informal Organisation

The benefits of informal organisation will accrue only when it is properly controlled and its potential power properly channelised. The significant aspects of manager's duty in this connection are:

(1) He should recognise and reconcile himself to the existence of informal organisation.

(2) He should influence the informal organisation so that its role is positive and the negative aspect is minimised.

(3) He should integrate informal organisation with the formal organisation in such a way that the former also contributes to the accomplishment of enterprise objectives.

(4) He should make informal organisation secondary to formal organisation, and not vice versa.

Growth in Organisation

Organisational growth, unlike growth of organisms which is a natural, evolutionary process, can be planned, expedited, stabilised, controlled and even retarded keeping in view the strategic plans of action. However, the given, growth as an objective of the organisation, it would be a worthwhile exercise to study the process of growth in organisations. Larry E. Greiner has provided a sound theoretical framework to analyse the process of organisational growth. He argues that growing organisations move through five relatively calm periods of evolution, each of which ends with a period of crisis and revolution. According to him, "each evolutionary period is characterised by the dominant management style used to achieve growth, while each revolutionary period is characterised by the dominant management problem that must be solved before growth will continue.

As organisation grows from small to large size, initially there is growth through the creativity of the founders who are usually technically or entrepreneurially-oriented, but soon management problems occur that cannot be handled through the mere dedication of the founders and through informal channels of communication. A crisis of leadership develops. To meet this, a strong manager is appointed. This new manager takes most of the responsibility for initiating direction, while lower level supervisors get tasks carried out without enjoying any decision-making authority. As the organisation grows further, these lower level officers demand more autonomy. The crisis of autonomy occurs. To handle this situation, authority is delegated to lower level managers. But soon these levels internalise sub-unit goals and it becomes difficult for the top manager to control and integrate their activities. So growth through delegation leads to a crisis of control. There is need for coordination of their activities as centralisation is now no longer possible. So elaborate rules and regulations are developed to obtain proper coordination but this itself creates the crisis of re-tape. It is hoped, perhaps, that this crisis can be overcome through collaboration. Hence, there is growth through collaboration in which people work as teams and social control and self-discipline take the place of formal control.

Thus, as the enterprise grows, the structure undergoes a change. The movement, in general, appears to be towards greater autonomy, flexibility and informality and is conducive to adaptiveness and innovativeness that are key to organisational effectiveness and success.

SELF-TEST QUESTIONS

1. Explain the term "departmentation". Suggest the various bases for departmentation in a business enterprise.
2. What are the basic factors to be considered while creating departments?
3. Distinguish between departmentation by functions and departmentation by

products.

4. Compare Line, Functional and Line and Staff Organisation. Which of these is suitable for a big manufacturing enterprise?
5. Define Project Organisation. Mention the resulting organisation structure under project management.
6. What are the advantages of the Project Organisation and Matrix Organisation structure?

Suggested Readings:

(1) Principles of Organisation — *J.D. Mooney*
(2) Modern Management — *David R. Hampton*
(3) Principles and Practice of Management — *W. Harnes*
(4) Organisation and Management — R.D. Agarwal
(5) Management — *James A.F. Stoner & Charles Wankal*

STUDY XII

STAFFING

Meaning, Nature and Functions of Personnel Management

With the increase in size and complexity of business organisations, man has become the most important factor in business. Any human organisation consists of people working together. Even in these days of automation, machine is useless without human beings to run it. The human problem is present everywhere. According to Lawrence Appley, management and personnel management are the same. He says management is the development of people and not the direction of things. Management and personnel administration are one and the same. They should never be separated. Management is personnel administration.

Personnel Management is concerned with people at work and their relationships within an organisation. Since an organisation consists of people interacting with each other for achievement of the common goals of the enterprise, there exists certain well defined relationships among them. Each individual has to coordinate his efforts with that of his superiors/peers/subordinate. Therefore Personnel Management is concerned with people at all levels.

Personnel Management is regarded as an all pervasive function permeating all levels and all branches of management. Managers at all levels have to manage the persons who are working under them. They have to plan their manpower needs, organise their people, direct their efforts for achievement of goals, coordinate the group effort to provide units of action and control them.

Definitions of Personnel Management

A few standard definitions given by experts of Personnel Management are reproduced below:

1. "The personnel function is concerned with the procurement, development, compensation, integration, and maintenance of the personnel of an organisation for the purpose of contributing toward the accomplishment of that organisation's major goals or objectives. Therefore, personnel management is the planning, organising, directing and controlling of the performance of those operative functions."

   —Edwin & Flippo: Principles of Personnel Management

2. "Personnel Management is that field of management which has to do with planning, organising and controlling various operative activities of procuring, developing, maintaining and utilising a labour force in order that the objectives and interest for which the company is established are attained as effectively and economically as possible and the objectives and interest of all levels of personnel and community are served to the highest degree."

   —M.J. Jucius: Personnel Management

3. "Manpower Management effectively describes the processes of planning and directing the application development and utilisation of human resources in employment."

   —Dale Yoder: Personnel Management and Industrial Relations

4. "Personnel Administration is a method of developing the potentialities of

employees so that they get maximum satisfaction out of their work and give their best efforts to the organisation."

—Pigors and Myers: Personnel Administration

5. "Personnel Management is that part of management process which is primarily concerned with the human constituents of an organisation."

—EFL Brech: Principles and Practice of Management

6. "Personnel Management is that part of the management function which is concerned with people at work and with their relationships within an enterprise. Its aims is to bring together and develop into an effective organisation the men and women who make up an enterprise and having regard to the well being of an individual and of working groups to enable to make their best contribution to its success.

—The British Institute of Personnel Management, U.K.

7. Personnel Management is that part of the management function which is primarily concerned with human relationships within an organisation. Its objective is the maintenance of those relationships on a basis which by consideration of the well being of the individual, enables all those engaged in the undertaking, to make their maximum personal contribution in the effective working of the undertaking.

—Indian Institute of Personnel Management, Calcutta

Functions of Personnel Management

Basically, there are two categories of functions involved in personnel management. These are managerial and operative. The managerial functions are concerned with planning, organising, directing and controlling personnel. The operative functions of management are concerned with selection, training, placement etc. of staff.

The Managerial Functions of personnel management can be explained as under:

(i) Planning

Effective managers realise that a substantial portion of their time should be devoted to planning. For a personnel manager, planning means the determination in advance of a personnel programme that will contribute to the goals established for the enterprise i.e. anticipating vacancies, planning, job requirements and descriptions and determining the source of recruitment.

(ii) Organisation

After a course of action has been determined, the personnel manager has to establish an organisation to carry them out. This function involves grouping of personnel activities to different individuals, delegation of authority to carry them out, and provision for co-ordination of authority relationship horizontally and vertically in the organisation structure.

(iii) Motivation

It involves encouraging people to work willingly and effectively. The personnel manager must inculcate in the workers a keen appreciation of enterprise policies. It involves career planning, salary planning and administration, ensuring employee morale, developing cordial industrial relations and provision of safety requirements

and welfare of employees.

(iv) Controlling

It is concerned with regulation of activities in accordance with the personnel plans. It involves observation and comparison of results with the targets and correction of deviations that have occurred and helps in evaluating the performance of personnel department in discharging the various operative responsibilities.

Some of the important operative functions of personnel management are as under:

(i) Procurement, Recruitment and Selection

This function is basically concerned with the employment of right kind and right number of persons in order to achieve the objectives of the organisation. The function basically involves manpower planning, recruitment, selection, placement, training, promotion, transfer and other related problems.

(ii) Training and Development

Training and development of employees is another important operative function of personnel management. It is basically concerned with arranging various programmes in order to improve knowledge, skills and abilities of employees for achieving their better performance on job. Training and development programmes basically are designed to improve employees efficiency on the job, orientation to achieve and improve decision making abilities etc.

(iii) Compensation

This function deals with the determination of adequate and equitable remuneration of the people in the organisation for their contribution to the organisational goals. The basic components of compensation programmes are job evaluation, wage policies, wage systems, incentives and terms of employment.

(iv) Integration

Integration function is concerned with the reconciliation of interest of personnel with that of the organisation. Some of the major constituents of this function include negotiation with trade unions and collective bargaining.

(v) Performance Appraisal

It is concerned with the evaluation of individual's performance on the job and his potential for development.

(vi) Motivation

Motivation function is basically concerned with the encouragment of employees to work willingly in order to attain optimum level of efficiency towards the achievement of organisation goal.

(vii) Maintenance

This function includes various health and safety measures for employees on work in the organisation. It also covers various welfare measures such as canteen, education of employees' children and insurance.

In this study lesson staffing which is an important aspect of personnel

management is discussed in detail.

STAFFING

Meaning and Nature of the Staffing Function

Basically, the staffing function of management refers to the manning of an organisation structure which would otherwise remain an empty shell of job-positions. It involves determination of the man-power requirement, recruitment, selection, placement, training, development, job transfer and appraisal of personnel to fill the organisation positions.

Staffing is a never-ending, continuous function. When an organisation comes into being, people have to be employed in various jobs. With the growth and expansion of business, additional manpower is needed; vacancies caused by mobility of personnel or retirement of existing employees must be filled from time to time either by promoting people and/or by making fresh recruitment. Thus, most of the staffing functions must be undertaken as ongoing activities throughout the life of an organisation.

Staffing was once considered a part of the organisation function of management, but it is now regarded as a separate function concerned with securing and maintaining a competent and dedicated work force including both managers and operatives. According to some writers, the staffing process with regard to operating personnel should be treated as a part of the personnel function, while the staffing function as a responsibility of the executives should be concerned with the managerial personnel. From this view point, the specific task of “acquiring and assigning management manpower” is termed staffing. “Staffing is the executive function which involves the recruitment, selection, compensating, training, promotion and retirement of subordinate managers”. (Koontz and O’Donnel) Staffing is “concerned with the placement, growth and development of all those members of the organisation whose function is to get things done through the efforts of other individuals”. (Theo Haimann). These views are based on the fact that considerations in staffing with respect to managers have certain implications which are different from those relating to staffing with respect to operative personnel.

Importance

The importance of staffing as a function of management arises from the importance of human resources in an organisation. Staffing involves manning the organisation structure through proper and effective recruitment, selection, training, development and appraisal of personnel to fill the roles designed into the structure. Thus, staffing ensures the availability of the required human resources at all times. The importance of staffing as a separate function may be attributed to the following reasons: (1) the staffing of organisational roles includes knowledge and approaches not usually recognised by practising managers, who often think of organising as just setting up a structure of roles and give little attention to filling these roles; (2) it is the staffing function that brings together the human assets and organisational design; (3) staffing enables due emphasis being given to the management of procuring and maintaining human resources which involve various complexities peculiar to human beings; (4) it is the quality of manpower in an organisation specially its managers, that determines the efficiency of performance of the enterprise.

The Logic of Staffing

Since in staffing, the positions are filled not only for the present but also for the future, staffing must deal with future requirements. The question of the length of futurity of staffing plan depends upon commitment principle and the degree of flexibility of the organisation.

The logic of staffing indicates that staffing should be regarded as a system and as a sub-system of total system of managing. Staffing is closely interrelated with organisation structure planning, which in turn is dependent on enterprise plans. Within the staffing area itself, selection, appraisal, inventorying and development are closely related.

Staffing requires an open system approach. After all, it deals with people who are products of, and continue to interact with their total environment – an environment which is far broader than any particular enterprise or operation.

The Staffing Process

The staffing process includes a number of activities, e.g.,

(1) Estimate the size and make up of the future manpower needs (Manpower Planning);

(2) Acquiring the most competent and qualified applicants to meet the manpower needs (Recruitment);

(3) Evaluating the applicants for different positions choosing the best candidates and assigning them to the right jobs (Selection and Placement);

(4) To arrange training and development of the employees to secure efficiency of operation (Training and Development);

(5) Periodic evaluation of the performance of employees (Performance Appraisal); and

(6) Promotion and transfer of employees (Job Changes).

Manpower Planning

Manpower planning is the process by which management determines how an organisation should move from its current manpower position to a desired manpower position. It consists of defining the present needs and estimating the future needs of manpower in an organisation. It is through manpower planning that management ensures that it has the right number of people and the right kind of people, at the right place, at the right time, doing things for which they are best suited. It is a strategy for procurement, development, allocation, utilisation and maintenance of human resources of an enterprise.

The significance of systematic and comprehensive manpower planning has been recognised by all organisations. Earlier, the management of small organisations had the common belief that they could always obtain the personnel as and when required. In the present corporate environment, formal manpower planning is essential for all big organisations which must meet and manage changes in technical know-how products, markets and internal organisation, and which utilise lot of personnel talent.

Some of the major benefits of manpower planning in an organisation are as

under:

(i) Manpower planning is vital because it helps in determining the personnel needs of the organisation.

(ii) It enables the organisation to cope with changes in competitive forces, markets, technology, product, etc. all of which often generate changes in job contents, skill demands, number and type of personnel.

(iii) It is an essential component of strategic planning.

(iv) It helps in selection and development of employees as it ensures that adequate number of persons are selected well in advance and developed for anticipated openings. This also ensures a smooth working of the organisation.

(v) It enables the organisation to procure personnel with necessary qualifications, skill, knowledge, work experience and aptitude for work.

(vi) It helps in finalising managerial succession plan as a part of the replacement process by providing enough opportunity for identifying and developing managers to move up the corporate ladders.

(vii) Suitable manpower planning helps to ascertain and identify the areas of critical shortages of skilled employees and enables management to avoid breakdown in production process or under utilisation of plant capacity by taking timely corrective action.

(viii) It helps to identify the surplus manpower, if any, in the organisation.

The overall policies, plans and programmes of the organisation are the determinants of the manpower planning. Thus, manpower planning is an integral part of corporate planning. It determines the manpower requirements and the means for meeting those requirements in order to carry out the integrated plan of the organisation (Coleman).

The activities involved in planning for human resources are:

(a) *Forecasting* future manpower requirements in terms of quality and quantity, either on the basis of projections of trends in the economic environment and developments in industry, or on the basis of judgmental estimates in accordance with the specific plans and programmes of the company;

(b) *Making an inventory* of present manpower resources and assessing the extent to which these resources are employed optimally;

(c) *Anticipating* manpower problems by projecting present resources into the future and comparing them with the forecast of requirements to determine their adequacy, both quantitatively and qualitatively; and

(d) *Planning* the necessary programmes of recruitment, selection, training, development, utilization, transfer, promotion, motivation and compensation to ensure that future manpower requirements are properly met.

In short, the steps in manpower planning consist of projecting future manpower requirements and developing manpower plans for the implementation of the projections. It should not be regarded as a rigid formulation; it is amenable to modification, review and adjustments according to the needs of an organisation or changing circumstances.

In actual practice, the forecasting of future manpower needs is made on the basis of production and sales forecast, work-load analysis, work-force analysis and estimated turnover of employees. The quality of personnel required is defined *by job analysis and recorded in job descriptions and personnel specifications.*

Job Analysis

A job is defined as the collection of tasks, duties and responsibilities which may be regarded as the assignment to individual employees. A job may include many positions; a position being defined as a job performed by and hence related to a particular employee. Job analysis is the procedure by which the facts with respect to each job are systematically identified and rated. It is the process of determining the contents of a job in terms of what the job-holder (employee) is expected to do, his duties and responsibilities as well as the skills required for performance of the job. Job analysis provides the information for the preparation of job description and personnel specification.

Job Description

Job description is a systematic outline of information gained from notes taken and recorded in the process of job analysis. It is a factual statement and summary of the job contents in terms of the job title, job duties, equipments to be used, working conditions, supervision needed, hazards, relationship with other jobs and personal requirements of the job.

Personnel Specification

Personnel specification refers to summary of personal qualities required for successful performance of a job. It specifies the skill experience, special aptitudes, if any, and other qualifications which the job-holder should possess.

Job analysis is often regarded as fundamental to manpower management as the information provided by job analysis can be used for various purposes, e.g.,

(a) Organising and integrating the work force;
(b) Recruitment, selection and placement;
(c) Transfers and promotions;
(d) Training programmes;
(e) Wages and salary administration;
(f) Improvement of working conditions; and
(g) Raising productivity through work simplification and methods of improvement.

Recruitment

Recruitment is the process of searching for prospective employees and encouraging them to apply for the jobs in an organisation. It aims at securing as many qualified applicants for jobs as possible so as to decrease the hiring ratio.

Before searching for applicants, an organisation should consider the most likely sources of the type of employees it needs. The sources of recruiting may be internal and external.

Internal Sources

The internal sources of recruitment include personnel already on the pay-roll of

an organisation. It also includes personnel who were once on the pay-roll and wish to return, or whom the company may like to re-hire, like those who left their jobs voluntarily or were laid off. Recruitment from internal sources so as to fill up vacancies by transfer, promotion, or re-hiring previous employees, offers several advantages:

(i) Selection and placement of existing employees are simple and economical.
(ii) The employer is in a better position to appraise the skill and capability of present employees accurately.
(iii) It improves employee morale as internal promotions provide opportunities for advancement.
(iv) It promotes loyalty among the employees.
(v) Persons already employed can be more easily inducted and trained for new jobs.

However, recruitment from within the organisation often leads to in-breeding and prevents the 'infusion of new blood' into the organisation. As promotion is based on seniority, internal recruitment involves the danger that unsuitable employees may get promoted and the really capable persons may be left behind. In any case, it narrows down the area of selection and does not provide equal opportunity to all qualified persons to be considered for the jobs. Besides, recruitment at lower levels have to be made from outside the organisation.

External Sources

These sources lie outside the organisation, and usually include:

(i) Persons introduced and recommended by present and former employees or trade unions;
(ii) Employment Exchanges and private employment agencies;
(iii) Open advertisements;
(iv) Educational, technical and professional institutions;
(v) Contractors and jobbers;
(vi) Gate hiring of unskilled workers;
(vii) Casual applicants; and
(viii) Temporary or badli workers.

Encouraging present employees to recommend candidates for employment helps management both in finding suitable candidates and in maintaining goodwill among employees. But this may also encourage family cliques and inner circles of close friends. In general, external recruitment through open advertisement provides a wide scope for selection from among a large number of candidates with requisite skill and competence. It proves to be most useful for filling up managerial positions requiring technical and professional qualifications.

Selection and Placement

Selection

Selection is the process by which candidates for employment are distinguished between those who are suitable and those who are not. It involves rejection of some candidates and is sometimes described as a negative process in contrast with the

positive programmes of recruitment.

Selection starts with reference to job specifications which indicate not only immediate job requirements but other qualities which may be desirable in the long run. Usually, the personal qualities which form the basis of selection include: skill, experience, age, education and training, physical characteristics, intelligence, aptitudes, emotional stability, attitude towards work and personality.

The selection procedure may differ according to the types of jobs and candidates. The most common practices are outlined below:

(i) *Screening:* The first step in all cases involves screening i.e., shifting of applicants to avoid further consideration of those who are obviously unsuitable.

(ii) *Application blank:* Blank application forms are issued to candidates who possess the minimum qualification so as to elicit full information about them. The forms are required to be filled in by the candidates in their own handwriting. Application blank may be developed to serve a highly effective screening device. The exact nature of the information to be provided depends upon the job to be filled up.

(iii) *Preliminary interview:* An interview at the preliminary stage may be arranged consisting of exchange of information to determine whether it is worthwhile for the candidate to fill up the application blank.

(iv) *Employment tests:* Formal testing of candidates has become a common practice in selection as a supplement to direct personal interviews. A wide variety of tests have been developed for potential employees of different categories. There are six common types of tests used in the selection process to examine the candidates' performance, intelligence, aptitude, interest, personality and dexterity.

Performance tests seek to measure the level of proficiency and skill of the candidates in the performance of the job. Intelligence test provides a measure of the candidates intelligence quotient indicating his mental ability including memory, vocabulary, perception, reasoning, etc. Aptitude test is used to measure the applicants' capacity and his potential for learning the skills required for a job. Interest tests are designed so as to identify the candidates' patterns of interests i.e., areas in which he shows special likings, fascination and involvement. *Personality* tests are used to probe for the dominant traits of the personality as a whole in terms of temperament, maturity and emotional balance. *Dexterity* tests are aimed at knowing the ability of a candidate to use his limbs (different parts of his body) in a co-ordinated manner.

(v) *Employment interview:* Face-to-face interview before final selection is an important step which not only acts as a check on the information already obtained but also provides an opportunity to form a better understanding of the candidate, to motivate him and inform him about the job and the company. Interview by a panel or board is more often in practice for supervisory and managerial positions. It facilitates pooling of judgements about a candidate and subjective bias of individual members on the panel does not affect the final decision. Sometimes candidates are interviewed in small groups rather than individually. They are given a problem and asked to

reach a decision through discussion within a certain time. Some observers watch how the candidates interact with each other reflecting qualities of leadership, communication, persuasion, etc. There are different types of interview which may be arranged for selection: *(a) Structured or Patterned interview; (b) Unstructured or non-directive interview; (c) Depth or Action interview; (d) Stress interview.* In a structured interview, specific questions to be asked by the interviewer and the areas to be covered are decided in advance. The same set of questions is used for every candidate and the questions are asked in the same sequence. The non-directive or unstructured interview is not planned as regards the questions to be asked. The candidate is allowed to talk freely on general questions and the purpose of interview is to find out what kind of a person the candidate is. The depth interview is semi-structured. Questions are asked on key areas of the candidate's home life so as to ascertain his background and way of thinking. In the stress interview, there is a deliberate attempt by the interviewer to provoke, embarass or annoy the candidate and to put him under stress through frequent interruptions and critical comments. The purpose of stress interview is to find out how the candidate reacts in a stress situation.

(vi) *References and Medical Examination:* Applicants are often required to give names of persons to whom references may be made about the candidate's character and suitability for the job. Two types of references may be required: Character reference as a potential sources of information regarding the general character of the applicant; and *former employer reference*, one who may be able to speak about the applicant's earlier work. Checking on the references is considered to be helpful in selecting employees particularly those to be assigned heavy responsibilities. However, the limitations of references are apparent. References are likely to be selected by the applicant to include only those who will speak well of him. References may also be reluctant to provide critical information directly related to requirements. Some companies use specially designed letters of inquiry stating the qualities identified in job specifications.

Medical examination of the candidate may be required for several reasons viz., to ensure that he is physically fit for the job, that he does not suffer from any latent disease, and the firm does not become liable for any claim under the Workmen's Compensation Act.

(vii) *Final Selection and Job Offer:* On completion of the selection procedure, candidates are finally selected and letters of appointment are issued stating the terms and conditions of employment including the pay-scale, starting salary, allowances and other benefits, the period of probation, etc.

Selection and Recruitment

Recruitment is the process of identifying sources for prospective candidates who may be stimulated to apply for job in an organisation. The main objective of recruitment is developing and maintaining adequate manpower resources with the required skills upon which organisation can depend when it needs additional personnel. It helps management to search for competent personnel from among eligible qualified candidates.

As against recruitment, selection is the process of logically choosing individuals who possess the necessary skills and ability to successfully fill specific jobs in the organisation.

Recruitment is regarded as positive function as it aims at identifying and stimulating candidates to apply for jobs in large number whereas selection is more of a negative function because number of candidates chosen is invariably less than those rejected.

Thus, recruitment is the process of searching prospective employees and stimulating them to join the organisation whereas, selection is the process of choosing the persons most competent to do particular jobs.

Placement

Placement of the selected candidates on specific jobs involves matching the persons employed to the jobs for which they are best fitted. Placement refers to assigning specific jobs to the selected candidates.

Induction and Orientation

A new employee generally takes time to settle down to his job. Introduction of the employee to the job, his colleagues and to the organisation is aimed at helping the employee to adjust himself to the environment. The process of introduction and orientation is referred to as induction. It serves two purposes: (a) familiarising the employee with his new surroundings and company rules and regulations; and (b) integrating his personal needs with the organisational goals. The induction programme generally consists of two phases. In the first phase, it is done by the personnel department and information is passed on to the employee about the company history, products and major operations, structure of the organisation and functions of various departments, general policies and practices regarding pay, hours of work, discipline, safety and hygiene, recreational activities as well as opportunities for promotion, transfer etc. In the second phase, induction of the employee is a responsibility of the supervisor whereby the employee gets acquainted with his job, work team, working conditions and above all, establishes his rapport with the supervisor.

Training and Development

Employee training and development are integral parts of the staffing function of management. Training implies a systematic procedure whereby employees are imparted technical knowledge and skill for specific jobs. It emphasises improvements of the abilities of employees to handle specific jobs and operations more effectively. Development, on the other hand, implies an educational process aimed at growth and maturity of managerial personnel in terms of insights, attitudes, adaptability, leadership and human relations, on the basis of conceptual and theoretical knowledge.

Training and development programmes are generally designed in accordance with the nature of the job, personnel concerned (operatives, supervisors, managers) and the purpose in view. The programmes can be broadly divided into two categories: *On-the-Job Programmes;* and *Off-the-Job Programmes.*

Training of operatives and skilled workers are mostly organised by way of: (i) Training on specific jobs; (ii) Vestibule training with separate sets of tools and equipment in a special training centre; (iii) Internship training with the co-operation of vocational training institutions; (iv) Apprenticeship training combining job-experience with class-room instruction; and (v) Job rotation involving transfer from job to job on a systematic basis.

Supervisory and managerial training programmes are mostly off-the-job programmes. One or more such programmes commonly used are the following: (i) Class-room lectures; (ii) Conferences; (iii) Group discussions; (iv) Case studies; (v) Role-playing; (vi) T-group training; and (vii) Programmed instruction.

Management development programmes may consist of (i) In-basket programme for identifying executive potentials and developing decision-making abilities; (ii) Management games to develop capabilities of decision-making in a competitive situation of a realistic nature; (iii) Sensitivity training aimed at developing awareness of and sensitivity to behavioural patterns of oneself and others; (iv) Committee assignments or membership of junior boards; (v) Simulation and role-playing, and (vi) Transactional analysis for improving communication abilities, human relations and managerial interaction with subordinates.

The investments made in training, benefit an organisation in ways more than one:

(i) Training helps to improve the quantity and quality of workforce. It increases the knowledge and skills of employees and improves their performance.

(ii) It helps to reduce the time and cost required to reach the acceptable level of performance. It prevents employees' obsolescence. Accidents are reduced.

(iii) It enables the organisation to fill manpower needs. Promising employees can be spotted and trained for higher level jobs.

(iv) Trained employees make better and economic use of materials and equipment. Maintenance cost is reduced and the life of machines and equipment is increased.

(v) It helps to reduce the need for constant and close supervision of workers. It facilitates "management by exception".

(vi) It helps to improve the job satisfaction and morale of employees resulting in improvements in their earnings, job security and career prospects.

(vii) It facilitates delegation and decentralisation of authority. Trained employees are willing to accept new and challenging assignments.

Similarly, the investment made in management development benefits the organisation in the following ways:

(i) It prevents managerial obsolescence by exposing executives to latest concepts and techniques in their respective fields of specialisation.

(ii) It ensures that the company is staffed with a sufficient number of managers having requisite knowledge and skills.

(iii) It ensures long-term survival and growth of the organisation.

(iv) It replaces old executives with younger ones, i.e. to develop a second line of

competent officers for future replacement.

(v) It creates group cohesiveness or teamwork.

(vi) It ensures that managerial resources of the organisation are properly and fully used.

Job Changes

Recruitment from internal sources involves job-changes of existing employees by way of promotion and transfers. Promotion refers to the advancement of an employee to a higher level position involving greater responsibility, better pay and higher status. A transfer involves the shifting of an employee from one job to another which may occasion changes in duties and responsibilities and may also involve change in pay.

Promotion Policy

Boardly, promotion may be defined as a movement to a position in which responsibilities and prestige are increased. Promotion results in higher earnings but not always.

Since promotion involves a vertical movement in rank and responsibility, it poses a delicate problem to the executives in selecting the incumbent and making the selection acceptable to all concerned. The policy of filling vacancies at higher levels through promotion is widely accepted in modern organisations. It serves the purpose of recognising an employee's performance and provides incentive for improved performance. It builds up morale, loyalty and a sense of belongingness among employees, promotes job satisfaction and thus improves the organisational effectiveness.

Basis of Promotion: Seniority v. *Merit.* Whether employees should be selected for promotion on the basis of seniority (i.e., length of service) or merit (i.e. ability) has been widely debated. Trade unions and employees prefer promotion by seniority while executives by and large are in favour of promotion based on performance and ability.

Seniority as the basis of promotion provides an objective criterion and prevents arbitrary selection or favouritism. It develops a sense of loyalty to the organisation, reduces employee turnover and minimises disputes on promotion. One may also argue that seniority is a good enough measure of experience and hence of ability. However, promotion by seniority provides no incentive for improved performance as it does not involve any distinction between more efficient and less efficient employees. Thus, it tends to demoralise competent persons and leads to higher turnover and mobility. With a promotion policy based on seniority, the organisation may not be able to attract capable and talented personnel. The strongest argument against such a policy is that experience which goes with longer service does not make any one more competent.

On the other hand, merit based promotion provides due incentives to employees for continuous improvement in work performance. This adds positively to overall organisational effectiveness and success. The limitation of merit based promotion policy is that it is difficult to assess merit objectively and leaves wide scope for arbitrariness and favouritism. Thus, it may cause frustration and loss of interest in work among many. If trade unions are opposed to it, the organisation may suffer

from unstable industrial relations.

Considering the pros and cons of seniority and merit based promotion policies, a sound policy in practice is expected to provide for a judicious mix of the two criteria. Thus, the most widely used basis for promotion combines both seniority and merit which provides for ability or merit being the deciding factor in promotional selection where two employees are of equal seniority. Similarly, between two employees who are almost equally competent, one who is senior in service should be preferred for promotion. Many companies have also adopted the policy of filling up a certain number of vacancies at higher level on the basis of seniority and a certain promotion on the basis of ability or merit. It is desirable to supplement promotion policy by various types of tests and examinations designed to measure knowledge and skill required for various jobs.

Transfer Policy

Transfer of an employee implies a lateral or horizontal movement from one particular position to another at same level within the organisation. There may be change in duties and responsibilities as well as change of pay in the event of transfer but it does not involve higher status or rank. Transfers generally are aimed at building up a more satisfactory work team and it may serve different purposes. Thus transfers may serve the purpose of meeting organisational needs arising out of changes in the volume of activity and work load in different functional areas. Such transfers are known as *production transfer, flexibility transfer or organisational transfer*. Employees may also be transferred on their personal request so as to meet individual preferences. These are known as personal transfers. When executives find particular employees more suitable or useful in other jobs, or when transfer is considered necessary to rectify the original placement of an employee, it is known as remedial transfer. Transfers made with the object of making employees conversant with different jobs are known as versatility transfer.

The circumstances in which employees may be transferred depends upon the transfer policy of management. A satisfactory transfer policy should clearly specify the types of transfers and the conditions under which transfers will be made. Managers authorised to initiate and implement transfers should be identified. The policy should indicate the basis on which transfer will be made. The basis of transfer may be seniority, competence or other factors. Whether transfers can be made only within a unit or between departments and divisions should also be decided as a part of the policy.

Performance Appraisal

The effectiveness of staffing function needs to be ascertained by evaluating the performance of employees in terms of job requirements. Performance appraisal or employee appraisal is the systematic process of measuring and evaluating employees with respect to their performance on the jobs and their potential for development. Although, performance appraisal is often described as merit rating, strictly speaking rating is only one form of personnel evaluation. Merit rating refers to various formal systems of appraisal in which the individual employee is compared with others and ranked or rated. Performance appraisal is a more comprehensive process which combines formal ratings with supplementary observations, records

and evaluation (Dale Yoder).

Performance appraisal is useful to make number of decisions on personnel management: (i) It helps to assess present and future potential of employees and determining their training and development needs. (ii) It motivates employees to learn and grow. (iii) It helps to decide matters relating to employee transfer and promotion. (iv) It also helps to appraise the reliability of selection policy and procedure.

Performance appraisal helps the organisation in better decision making and planning of manpower in order to make effective and judicious use of resources.

Methods of Appraisal

Performance appraisal may be undertaken either in terms of the attributes of traits of the employees i.e., skill, knowledge, experience, etc. (known as the trait approach) or with reference to the results achieved by the employees (appraisal by results).

(a) *Traits appraisal:* The basis of performance appraisal in terms of the qualities or traits of the employees, emphasises such evaluation criteria as quantity and quality of work done, skill, experience, knowledge of the job and characteristics of the individual such as initiative, intelligence, dependability, judgement, adaptability, industry, etc. There are several variants of traits appraisal method.

(i) *Ranking Method:* This is the simplest of all methods. The appraisal consists of ranking employees as more or less efficient by inter-personal comparison of overall qualities. This method may be conveniently adopted if the number of employees is small and work performance is measurable. The ranking thus made involves subjective appraisal of employees without any common standard.

A variant of the ranking method is the paired-comparison method, in which employees are compared and ranked in pairs. Each employee is compared with other employees in a group, one at a time. The results of these paired comparisons are tabulated and a rank is assigned to each employee.

(ii) *Rating-scale Method:* This method involves the use of a rating scale listing the qualities, attributes or characteristics which may apply to individual employees. The raters record their opinion indicating the degree to which each of the items apply to individual employees. For instance, the quality ‘initiative' may be divided into five degrees on the scale: ‘Exceptional', ‘Above average', ‘Average', ‘Below average' and ‘Poor'. The rater is to tick-mark the degree of initiative which he feels best applies to the employee being rated. The appraisal of each employee with respect to the characteristics indicates his merit.

(iii) *Graphic (continuous) Scale Method:* This method is similar to the Rating-scale Method except that the degrees of qualities or attributes on which employees are to be appraised are indicated on a graph or chart. The scale of attributes may be numerical-alphabetical or descriptive-adjective. Thus different degrees of an attribute may be stated as exceptional, above average, below average, and poor or assigned numbers 5, 4, 3, 2, 1.

(iv) *Check-list Method:* Employee appraisal under this method involves listing of a number of statements about the performance and behaviour of the

employee and the rater is to check these statements indicating whether a statement applies or does not apply to the employee or there is a doubt. Afterwards, values (or weights) are assigned to the statements depending upon their respective importance. The final rating of the employee is taken as the average of the scale value of all statements that the rater has checked.

(v) *Forced Choice Method:* The rating form used in this method also contains a list of statements about the employee. The statements are grouped in two's, three's or four's. Each such group may consist of all favourable statements or all unfavourable statements. The rater checks only one of the statements in each group which he believes the best characteristics of the employee (if it is a favourable group), and which he believes is least applicable to the employee (if it is a group of unfavourable statements). As in the Check-list Method, weights are assigned to the statements afterwards (i.e. subsequent to the rater's checking) and the employee's rating is determined by adding together the weights of the checked items.

(vi) *Forced Distribution Method*: The basic assumption made for using this method is that employees are distinguishable as outstanding, above average, average, below average and poor; and their number conforms to a normal frequency distribution e.g., 10% each in the highest and lowest categories, 20% each in the above average and below average categories, and 40% in the average category. The rater is required to distribute the employees in the five categories on the basis of their overall performance and attributes.

(vii) *Critical Incidental Method:* This method involves employee appraisal on the basis of events or incidents and the employee's reactions to the same reflecting positive or negative aspects of his behaviour. A continuous record of incidents is maintained by the supervisors and numerical scores are assigned according to the nature of employee's reaction to particular events.

Comments on the Traits Approach to Performance Appraisal: The traits approach to performance appraisal traditionally found useful has been criticised by managers as a subjective approach lacking in reliability. It is vulnerable to the judgement and bias of individual raters. Performance appraisal on the basis of traits or characteristics of employees assumes a positive correlation between performance on the job and the personal qualities of the employee concerned. This is a doubtful assumption.

(b) *Modern Methods of Performance Appraisal:* To improve upon the methods of appraisal traditionally in use, attempts have been made to adopt certain other methods particularly for the performance appraisal of managerial personnel.

(i) *Appraisal by Results or [Management by Objectives (M.B.O.)]:* Appraisal by results essentially implies evaluation of managerial performance in terms of verifiable objectives. The process involves appraising how efficiently managers set actionable objectives and how well these are attained. The focus here is thus on results accomplished and not on the personal qualities and attributes. The method emphasises setting and achievements of goals, participation of subordinates and time-bound results. The time span of appraisal is decided in accordance with the level of management and the

nature of goals established.

Appraisal by results means appraising the performance of each individual employee on a continuing basis in relation to mutually agreed objectives, set at the beginning of the year. This is also based on the concept of "Management by objectives". The main features of appraisal by results are:

1. The basis of appraisal is the performance against mutually-agreed targets. The broad areas of responsibility of the job are defined and from this statement of responsibilities, the performer would be required to establish his targets or a programme of task for a period, charting specific modalities for goal achievement.
2. It is a participative technique of performance appraisal as the target is discussed with superiors in advance and an agreed programme is evolved. At the conclusion of targeted period, the performer makes his own appraisal regarding his accomplishments which is substantiated with factual data. The superior comments on the work reported by the subordinate and supplements it with his observations.
3. It aims at developing the performance instead of merely evaluating it. As the system is considered to be more objective, the performer becomes an active agent and relates his performance to goal realisation.
4. It is a method of continuous performance of each individual employee through feedback, guidance and counselling in periodical meetings throughout the year. This is possible because, a continuous review exercise is also carried out to benefit the organisation in planning strategies, taking remedial measures and redefining targets.

(ii) *Appraising Managers as Managers:* This approach to performance appraisal involves evaluation of managers in terms of the basic functions and tasks of management. The logic of such evaluation is that managerial appraisal ought to be against standards which measure the quality of a manager, as a manager. With a given classification of the function, a series of questions are asked to appraise a manager's performance in each area.

SELF-TEST QUESTIONS

1. Explain the nature of staffing function. What is its importance in management?
2. State and briefly explain the steps involved in the staffing process.
3. What is meant by manpower planning? What are the activities to be undertaken in that connection?
4. Write brief notes on: Job Analysis, Job Description and Job Specification.
5. Critically discuss the pros and cons of internal and external sources of recruitment of employees.
6. Briefly state the important steps of the selection procedure usually adopted by firms.
7. What are the different kinds of employment tests used in the process of selection?

8. Explain briefly the difference between structured and unstructured interviews.
9. Define and differentiate between “training” and “development” of personnel.
10. Briefly explain the more common methods of training the supervisory and managerial personnel in an organisation.
11. Why do executives favour the policy of promotion by merit? What are the arguments generally given in favour of promotion by seniority?
12. What purpose is served by transfer of employees from one position to another?
13. Discuss briefly the more important methods of performance appraisal based on the traits of employees.
14. What are the main features of appraisal by results?

Suggested Readings:

(1) Management (7th Edition) — *Koontz, O’Donnell and Weihrich*

(2) Principles of Management — *Koontz and O’Donnell*

(3) Personnel Management and Industrial Relations — *Dale Yoder*

(4) Management — *Stoner and Warkel*

STUDY XIII

COMMITTEE IN MANAGEMENT AND CO-ORDINATION

COMMITTEE IN MANAGEMENT

The Concept of Committees

Committee does not represent a separate type of organisation like line, line and staff, or functional. It is rather a device which is used as supplementary to or in addition to any of the types of organisation discussed in earlier studies. Reactions to committee device range from positive and negative and encompass a good deal of honest and ubiquitous bewilderment. In spite of some adverse criticism and misuse of the system, the use of committees is quite widespread and constantly increasing. The psychologists and the social scientists are happy that committees in management have led the business away from the monolithic organisation to conjoint decision and consultative supervision.

A committee may be defined as a group of people performing some aspect of managerial function. It refers to a group of persons to whom a matter has been committed. A committee is a body of persons appointed or elected to meet on an organised basis for the consideration of matters brought before it.

A committee is sometimes referred to as a board, commission, task force or a team. Whatever be the title used, its essential nature is the same. Committee functions only as a group. Committee members normally have other duties to perform and their committee work is only a part-time assignment. Terms or administrative procedures often indicate the character and composition of committees in an enterprise. Membership in a committee is usually fixed and members are generally appointed, though in some cases they may be elected. Thus, members of a Board of directors are generally elected and not appointed.

Some committees perform managerial functions and make decisions, while others do not. There are committees constituted to make recommendations to the manager, who may or may not accept them. Similarly, some committees are constituted just to receive information and pass it on to the management.

Committees are generally formed as formal bodies with a definite structure. They have their own organisation with definite responsibility and authority delegated to them. Depending upon the authority enjoyed by it, a committee may be either line or staff. If a committee is assigned a task and given power to make decisions and implement them through subordinates responsible to it, then it is described as a line committee or a plural executive. If the relation of a committee to the superior is advisory in nature, it is viewed as a staff committee.

Committees are usually formal bodies with a defined authority, structure and established as part of the organisation structure. These committees are generally required to follow definite rules and procedures, which are often written. But even when unwritten, rules are usually binding. Committees which are organised temporarily without specific delegation of authority are commonly described as “informal” committees. Thus, the principal of a college desiring to know about group thinking or group decision may call a special meeting for some of the senior members of the staff. The compulsion of splintered authority may also give rise to informal committee. But even the most informal of these committees follow a set pattern. In

addition, some committees function on the basis of quorum, some on complete attendance of all the members, and others without calling for quorum or attendance.

Committees may also be differentiated on the basis of their being temporary or permanent. Informal committees are usually temporary but it does not mean that formal committees are always permanent. Thus, the top management may constitute a formal committee to go into the question of modernisation of plant.

Committee device is very popularly used in all types of undertakings and organisations - social, religious, political and business. Religious and social institutions prefer committee pattern to achieve wider participation in their affairs. Most of the affairs in educational institutions are run through various committees. Similarly, government activities also lean heavily on committees. There are quite a few cases of government agencies being managed by committees. In business also, committeeism is rampant. One outstanding example of widespread use of committee device in business is provided by the Board of directors' representing the highest organ in company management. This committee is created by law for all companies. There are also a number of other constituent groups in business, such as executive committee, bonus committee, works committee, grievance committee, and the like. In terms of levels of management hierarchy, committees are used at all levels in the organisation.

The Plural Executive

Certain committees are constituted to make decisions and perform certain managerial functions. A committee of this kind is referred to as the line committee, plural executive, or the executive committee. The plural executive may be established by law, or may be the result of a managerial decision. Board of directors, for example, is the executive committee established by law. Plural executives are also formed internally by managers at different levels in the organisation.

The plural executive enjoys authority to make decisions and manage. The executive committees are often found playing an important role in policy-making and developing major plans. Other committees, constituted by the Board may be Finance Committee, Audit Committee, Bonus Committee, etc. Such committees differ considerably in their extent of authority. Very often these committees are found making use of staff specialists.

Directors as a Board, constitute the top plural executive in a company. The artificial entity and separation of ownership from management require a company to be managed by the Board of directors. It is, however, observed that many of the Boards actually do not manage, though they are entrusted with the task of managing the whole of the affairs of the company.

Advantages of Committees

Committees are sometimes described as an organised means of passing the buck. There are also executives who complain bitterly about the inefficiency of the committee system. Cases lacking proper use or involving misuse of committee device are not insignificant. It is, however, better if committees are looked upon from the positive viewpoint and executives make proper use of the committee system. In this sense, committees can be advantageously used to accomplish a number of organisational goals. Group dynamics lend the committee system certain potential

advantages.

1. Integrated Group Knowledge and Judgement

An important reason for use of committees is the advantage of group dynamics and pooled knowledge and judgement over individual judgement. Committee is a very useful device to bring the collective knowledge and judgement of a group of people to bear upon a problem. There may arise problems requiring co-ordinated application of a number of knowledge areas. Thus, fundamental change in the present design of a product requires integrated knowledge from areas such as engineering, manufacturing and sales. Similarly, there are a number of problems defying clear- cut answers. Such problems may be solved through integrated group deliberations and knowledge. It is reasonable to expect that quality of decisions will improve. Pooled knowledge, experience and judgement composing different viewpoints may be an invaluable asset particularly when complex problems are involved.

2. Representation of Different Interest Groups

Committees are frequently used to give representation to important interest groups, such as creditors, customers, labour unions and shareholders. Board of directors are often selected on the basis of groups interested in the company or groups in which the company is interested. Financial Institutions may require representation on the Board of directors of a company before lending money to it. At middle and lower levels also, different interest groups can be represented in the committees. Thus, the general manager facing difficulty relating to some internal matter involving managers and specialists in different departments and activities, may form a committee not only to derive benefit of group knowledge and judgement but also to give representation to all such interested groups. At times, a particular group may refuse to cooperate if participation rights are denied. Committee system thus enables the manager to give representation to different interest groups and obtain a high degree of cooperation from them.

3. Co-ordination of Plans and Policies

The dynamics of business make the task of coordinating different activities in the enterprise more difficult and challenging. The committee provides a meeting ground for the individuals concerned so that they may reach an agreement on the steps in co-ordination. Since decisions in one department largely influence and affect activities in the other departments as well, the committee system by enabling to plan on group basis a programme involving several activities, offers an approach to the problem of coordinating inter-departmental activities. Members of the committee from different departments better understand the need for co-ordination and the means by which it can be achieved when they meet together, exchange ideas and know about plans and activities of other departments. There are also matters that require pooling the authority of different departments together before a decision can be made—commonly referred to as the “splintered authority”. Problems arising on account of splintered authority can be referred to higher level managers for their solution. But committees can also be used to bring together the different departments having decision-making prerogatives, and thus, ease the burden of top-level executives by allowing the lower levels to make decisions.

4. Executive Teamwork and Personal Interactions

Committee organisation recognises the importance of the cooperative nature of management actions and personal association in the development of teamwork. Instead of individual competition, the committee encourages group accomplishment. Committees formally constituted enlarge the scope for executive contacts and personal interaction between lower and higher levels of management, and thus secure conformity to common goals through sanctions of the group.

5. Wider Participation and Motivation

Committees permit wider participation by subordinates and employees in the decision-making process. This gives them a feeling of belonging, and a sense of security and self-fulfilment. Individuals participating in making a decision or planning a programme usually do not resist its implementation, rather, they feel more enthusiastic in accepting and executing it. Sometimes, therefore, the intelligent manager makes use of the committee system not so much to derive the advantage of group judgement but to bring the group to a foregone decision by his skillful leadership, quality and lucid presentation of facts, and thus make the participants feel strongly motivated for successful implementation of the plan. But such an approach carries with it a degree of risk and can subject the organisation to the destructive forces of compromise and indecision.

6. Improved Communication

Committee, offers a very useful instrument for transmitting and acquiring information. Face-to-face communication is generally a more effective form of communication than written reports and memoranda. Members of the committee learn about mutual problems simultaneously. Opportunity is also provided for on the spot clarification of any doubt.

7. Training Ground for Executives

Committee makes positive contribution to the executive training and development. Subordinates get an opportunity to have insight into the problems facing other executives and the organisation generally, and thus experience problems beyond their present responsibilities. Senior executives also get a chance to observe subordinates in action and teach them whenever necessary.

Disadvantages of Committees

Committee functioning is subject to a number of limitations and dangers. Some of the important disadvantages of committee system are mentioned below:

1. High Cost of Committees

Committee system is not only costly in terms of time it consumes, but also in terms of money involved. Members of committees are usually found complaining of the great amount of time it takes to sit through committee meetings. Committee work is time-consuming because every member is entitled to have his say and put forward his viewpoint. Thus, a committee of five has, at any one time, four listeners and one speaker. Further, time in working through committees is consumed by the requirement of members having to collect information or prepare reports. Time consumed in physical movement of the members to and from the place of meeting is also not insignificant. Money costs of a committee are directly related to the time consumed in committee deliberations and costs involved in preparing reports and maintenance of committee staff.

2. Compromise and Indecision

If the matter under consideration is simple, and there are no significant differences in opinion as to its solution, the executive is hardly justified in forming a committee. If on the other hand, differences of opinion exist and there has developed the tradition of unanimity before a decision is made by the committee compromise must be reached; or else there would prevail a climate of indecision. Such a compromise is likely to be the least common denominator of group agreement, and chances are that the decision may not be as strong and positive as it would have been if the individual manager had considered various aspects and had himself made the decision on the basis of facts. Moreover, in the committee arrangement the least competent may sometimes impede the efforts of the most competent.

It is sometimes suggested that majority rule can be employed to reach a decision when compromise is not possible. However, majority rule does not always lead to good decisions; rather, it creates the problem of majority group sometimes sabotaging the genuine interests of the minority.

3. Minority Domination

Group accomplishment should dominate the committee scene and committee decision should be based on the best judgement of the group. However, state of indecision and compromise and also the possibility of domination by one or a small group of influential members of the committee may pose a real danger to group deliberations and judgement. Thus, a strong Chairman, a high ranking line executive, a minority group, or a clique of a few powerful members may dominate committee meetings and browbeat it into accepting a decision.

4. Dividend Responsibility

When a particular task is assigned to an individual, he is solely responsible for its execution and accomplishment. However, a committee presents the example of joint responsibility. When the problem is submitted to a committee, authority is conferred upon it and the group of individuals constitute its membership. But in practice members do not exhibit a sense of responsibility expected of them; and group responsibility is rather taken to mean no body's responsibility. Dividend responsibility is thus a serious limitation of committee system.

Besides, individual managers may be tempted to shirk or evade decision-making responsibility simply because committee device is available. Thus, to hide his efficiency, evade the consequences of unpopular decision, or to avoid going through the difficult process of decision-making, the manager may hand-over the problem to a committee.

The manager should thus bear in mind the drawbacks, limitations and misuse of committee device while proceeding to make use of it. He should carefully weigh its advantages in the light of its limitations mentioned above, and only then determine the extent to which and cases where committee system is to be employed.

Misuse of Committees

The committee form has often fallen into disrepute through misuse. The following abuses should be avoided when setting up committees:

(1) *In place of manager:* A committee shouldn't substitute a manager. The

advantages of group thinking and participation in policy matter can be gained in most cases through advisory committee. Real decision making and managing should be left to the line executives. Thus, the committees should not be used to make decisions which individuals should make.

(2) *For research or study:* Research or study is an individual function. Even though individuals may be coordinated into a team when the solution to a problem requires data not available to a committee, no amount of discussion can turn up the missing information. Most committees, therefore, need research staff to provide analysis of alternative courses of action.

(3) *For unimportant decisions:* Committee's use should be limited to important matters only otherwise a lot of time will be wasted deliberating at length on trivial subjects.

(4) *For decision's beyond participant's authority:* The agenda should deal with matters within the competence of the members of the committee. Usually executives send their subordinate who has not been delegated the superior's authority or who hesitates to bind the superior. The result is that the committee can't function as intended.

(5) *To consolidate divided authority:* Sometimes the authority is so splintered, that group meetings are necessary to consolidate authority for making decisions. If divided authority can be eliminated by changing the organisation structure and redelegation of authority, recourse to a committee is certainly a misuse of the device.

Making Better use of Committees

Under certain circumstances committees can serve a very useful purpose in the running of different organisations. The following are the important suggestions to make committee a useful agency of management.

1. Clear Definition of Purpose and Scope of Committee

In order to avoid duplication and confusion and to improve its effectiveness, authority, scope, functions and organisational relationships of the committee should be clearly defined. Members of the committee with a well defined authority and scope are able to assess whether they are meeting their responsibilities to the organisation.

2. Proper size of the Committee

Committee work should not be hampered because there are too many or too few members. Size of the committee should not be increased simply because someone is to be obliged. Too many members in a committee will create problem of managing them and lead to indecision and compromises which is not always justified. Too few members will not make it truely representative of all interest groups and greatly reduce the benefit of integrated group knowledge and judgement. Thus, there should be a proper size of the committee. However, it is extremely difficulty to say what should be the optimum committee size. Five is generally considered to be an ideal number of members. But there is no sanctity behind this number. And committee size is largely influenced by factors like purpose of the committee, personal abilities and participative skills of its members.

3. Careful Selection of Members

Success of the committee device is largely dependent upon the personality and skill of its members. It is wise if members of equal status are selected as members of a committee. A subordinate member of the committee usually finds it difficult to oppose his senior in the meeting. Persons of similar organisational rank feel more free and comfortable to exchange ideas and discuss things. Similarly, members should feel committed to ground decisions and avoid individual domination over committee proceedings.

4. The Right Chairman

The committee Chairman should know his proper role. He should understand that his primary job is to expedite and facilitate progress of the meeting. The Chairman should be a highly skilled discussion leader and encourage members to express themselves freely. He should also know how to settle differences and integrate committee deliberations. The Chairman should plan for the meeting and supply members with necessary information well in advance.

5. Effective Committee Procedure

Logical procedure in conducing the meeting makes for effective committee operation. The Chairman should define each problem, solicit discussion and invite solutions. Each participant should be given a fair chance, and areas of agreement discovered. The entire group should be made to think together.

6. Follow-up of Committee Work

Merely finalising the decision of recommendations is not sufficient. Minutes of the committee meetings should be prepared and distributed to its members, and also communicated to the line superior. The management should in turn also inform the committee members as to the actions, if any, taken on the recommendations of the committee.

7. Evaluation of Committee Work

The work of the committee should be constantly evaluated in the light of its purpose and also to determine whether that purpose is still valid. Committees should not be allowed to become self-perpetuating. Evaluation of committee work should also be done in terms of the success and quality of its decisions or recommendations. Appraisal of committee work should extend further to determine whether it is worth the cost involved in working through it. Both tangible and intangible benefits and costs need to be considered.

CO-ORDINATION

Nature and Techniques of Co-ordination

Co-ordination is the orderly synchronisation of group efforts so as to provide unity of action in the pursuit of a common purpose. Differences in understanding, timing, effort, or approach create the need for harmonising individual efforts towards accomplishment of group goals. Co-ordination should rightly be considered as the essence of management, because each of the managerial functions of planning, organising, staffing, directing and controlling is an exercise in co-ordination. According to Tead, "Co-ordination is the effort to assure a smooth interplay of the functions and forces of the different component parts of an organisation to the end that its purpose will be realised with a minimum of friction and a maximum of collaborative effectiveness. Co-ordination is essential in situations where diverse activities and/or people are involved to carry out a task in pursuit of a common goal.

Co-ordination is considered as the essense of management for following reasons:

1. Management and its functions are an exercise in co-ordination. Different functions of management where effectively carried out lead to better co-ordination.
2. Co-ordination is involved in every function of management and hence should not be regarded as one of its functions.
3. Planning, organising, staffing, directing and controlling all involve co-ordination.

Co-ordination is different from cooperation. Cooperation is a voluntary collective action to serve a common purpose. Whereas, co-ordination is an art of synchronization of efforts so that the common goal is attained.

The need for co-ordination is all-pervasive and ever present in every organisation. However, co-ordination is by no means easily attained. In fact, with every increase in size and specialization, cohesion becomes more and more difficult. The best co-ordination will occur when individuals know how their actions and jobs contribute to the goals of the enterprise and how their functions are related to other functions in the organisation. Fayol has suggested three things for effective internal co-ordination:

(i) each department should work in proper harmony with the rest;

(ii) each department or division should be informed of its share in the group task; and

(iii) working schedule of different departments should be constantly attuned to circumstances.

Within the enterprise there must be achieved both vertical and horizontal co-ordination. Co-ordination between the jobs of different persons at different levels of management hierarchy is known as vertical co-ordination. Co-ordination between different departments operating at the same level in the organisation's chain of command is described as horizontal co-ordination.

Some of the important techniques to effect co-ordination between different activities and departments in the enterprise are discussed below:

1. Co-ordination through effective supervision.
2. Co-ordination through the process of organisation.
3. Co-ordination by personal contact.
4. Co-ordination through effective communication.
5. Co-ordination by group meetings.
6. Liaison men to facilitate co-ordination.

Co-ordination through Effective Supervision

The manager's skill in effectively supervising the work of subordinates will bring about co-ordination. Supervision is concerned with attaining harmonious and reciprocal performance of responsibility by subordinates. While supervising, the manager is to see that subordinates synchronise and coordinate their efforts among themselves and also in relation to other groups. It is through the process of supervision that the manager guides and determines the quality of collaborative efforts.

Co-ordination through the Process of Organisation

Organisation is a very powerful device for achieving co-ordination. Mooney even goes to the extent of pointing out co-ordination as the essence of organisation. Whenever activities are grouped and assigned to subordinates, the idea of co-ordination is uppermost in the mind of the manager. Proper authority delegation, for example, ensures vertical co-ordination.

Co-ordination by Personal Contact

Personal contact is another important technique of achieving co-ordination. Mary Parker Follett, for example, points out that all factors in a situation are reciprocally related and the co-ordination is best achieved through interpersonal, horizontal relationships of people in the organisation. People cooperate better when they understand each other's tasks.

Co-ordination through Effective Communication

Communication is also a very useful method to achieve co-ordination. Organisation is constantly being modified by internal and external changes. Communication through letters, procedures, reports, bulletins and a number of modern mechanical devices ensures that people in the organisation are well informed of the changing situation and provided with information necessary to ensure co-ordination. Newman is right when he says: "Since co-ordination is concerned with the inter-relationships of separate activities, it can be not better than the transfer of information about those activities to some common point or points, where the dovetailing takes place".

Co-ordination by Group Meetings

The essential requirements for effective co-ordination are not always present in the organisation. Henri Fayol points out three symptoms of lack of co-ordination:

(i) each department knows or wants to know nothing of the others and of the enterprise as a whole;

(ii) water-tight compartments exist between the divisions and offices of the same department;

(iii) no one thinks of the general interest. Initiative and loyalty are mostly non-existent.

Such an attitude on the part of the personnel is the culmination of inadequate co-ordination. Fayol suggests that the situation can be remedied by arranging weekly conferences of departmental heads. These conferences and group meetings help to inform the management about the running of the concern, make clear cooperation to be expected from different units of the enterprise, and help solve various problems of common interest. Group meetings thus help members from different departments to better understand the need for co-ordination and the means by which it can be achieved when they meet together, exchange ideas and know about plans and activities of other departments. In those cases where authority of different departments is required to be pooled together before a decision can be made, the use of group meetings as a co-ordinating device is more clearly seen.

Liaison Men to Facilitate Co-ordination

The device of liaison men or expediters is sometime used to facilitate co-ordination. Under certain circumstances when direct personal contact between the managers of various units and functions is not frequent, the gap may be filled through the use of liaison officers. The general manager is in a better position to act as a liaison man. However, because of his preoccupation with other important matters, recourse must be had to experts or other employees of ordinary ability to act as liaison men.

Liaison men should in no case be considered as a substitute to other direct means of securing co-ordination. This device is justified for temporary use only. Constant need for liaison men is an evidence of poor organisation.

External Co-ordination

No business operates in complete isolation. A large number of forces external to the enterprise have a great bearing upon the success and survival of the organisation. It is, therefore, the responsibility of the management to effect co-ordination of the enterprise with factors external to it. These factors have to be effectively countered and properly absorbed into the organisational system. External co-ordination thus refers to the efforts undertaken to adopt and integrate the enterprise with the dynamic business world and factors external to it.

The first step to bring about external co-ordination is to know all the pertinent external forces. Once these are identified, the manager can proceed to analyse their impact upon the enterprise and take suitable remedial or preventive measures so that the enterprise can effectively cope with them. The important external factors are interests of customers, investors, employees, changes in competitive situation, other enterprises, technological advances, and government policies and regulations.

Shareholders, debenture-holders and other creditors comprise investors of any company. Their main interests lie in safety of investment, reasonable rate of return and appreciation in the value of investments. Management should pursue the policy of promoting good relations with investors and thus ensure continuity of funds availability. Dividend and interest payments should be properly administered, and

proper relations should be maintained with them through their associations. Associating the investors with company management will go a long way in improving relations with them. With customers and employees also the problem of co-ordination is largely that of improving relations with them. Genuine complaints should be properly entertained and harmonious relations should be developed with their associations. Customer interest is largely co-ordinated with the enterprise through product publicity, marketing research and market oriented planning.

Another important area of external co-ordination is to counter and absorb into the organisational system the changes in competitive situation and the industrial economy. Competition is a very powerful economic institution and substantial decline in competitive strength of the enterprise will greatly influence the working and the very existence of the enterprise. Thus, management should keep a constant watch on the competitive strength of the enterprise and take timely action to effectively counter any move of the competitors likely to affect the enterprise. Marketing research and customer-oriented planning along with effective sales promotion programme can be of great help in securing this kind of co-ordination.

Proper liaison should also be built between the enterprise attempting to bring about external co-ordination and other undertakings in different fields. Thus, there must be co-ordination of the enterprise with other business units, such as shippers, suppliers and carriers. Trade associations, chambers of commerce and a number of other agencies, official or unofficial, can be profitably used to secure co-ordination with other enterprises.

The management should also be aware of the significant changes taking place in the industrial technology. Growth of the enterprise, future improvement in its efficiency and its competitive position, all are greatly influenced by its ability to keep pace with technological advances. In the same way, government activities and regulations affecting the business world have greatly multiplied. Importance of tax laws and other government regulations is indicated by the growing trend towards centralising treatment of these matters in different business enterprises.

Co-ordination is a continuing process and calls for conscious effort by management to achieve it. It is more effectively brought about by the successful performance of managerial tasks. Management should realise that co-ordination cannot be imposed from the top. To quote Tead, “Co-ordination is best assured where representatives of functional groups which are directly affected by or are involved in carrying out new policies are parties to the decision reaching process”. Management should also be equally conscious of its responsibilities to coordinate the enterprise with external factors.

Characteristic Features of Co-ordinating

(1) Co-ordinating is a dynamic process. It strives to bring about harmony among different variable factors.
(2) It is continuous in nature because it aims to achieve synchronization between efforts and end objectives of a concern.
(3) It permeates all other functions, all organisational units and all activities.
(4) It demands group efforts.
(5) Management should make deliberate efforts to bring about co-ordination.

Principles of Co-ordination

Co-ordination is more than a function of management. Indeed, some management experts have viewed it as total management. In this regard we may recall Koontz and O'Donnell: In their words, "it seems more accurate, however, to regard it as the essence of managership, for the achievement of harmony of individual effort towards the accomplishment of group goals in the purpose of management. Each of the managerial functions is an exercise in co-ordination".

However any endeavour to achieve effective co-ordination must be based on certain principles which may be enumerated as follows:

1. *Early start:* Successful co-ordination requires that any endeavour towards this direction must start at the early stages of planning and policy making. It is clear that if co-ordination is intended to be enforced after different tasks have been put into operation, it is likely to be more difficult to unify and adjust different activities that have already taken a definite shape.

2. *Direct contact:* This principle emphasises that co-ordination must be achieved through interpersonal, horizontal relationships of people in any organisation. The greater this understanding is, the wider and more compact becomes the foundation of unified action. There is no denying the fact that interchange of facts, ideas, belief and values among all levels of executives and their subordinates helps remove misunderstanding and thus pave the way of growing cooperation to achieve both common and personal goals. Unless mutual cooperation and understanding is there, no order to coordinate can help achieve co-ordination. For instance, if the heads of the sales and production department, heads of the sales and publicity departments, do not exchange their views regarding customers' demand and consequently the necessity of introducing a new product with massive publicity in the changing perspective, the organisation would hardly achieve success in achieving its ultimate mission. In fact, effectivity of any enterprise depends on the concerted effort of all the departments. And direct contact is, undoubtedly, the most effective tool to help grow and achieve co-ordination.

3. *Reciprocal relationships:* Another important basis for sound co-ordination is the understanding that all factors in an organisation are reciprocally related. And it calls for balancing these factors with one another. For instance, people in the marketing research department of any organisation can hardly deny the influence of sales department people or the outlook and attitude of the personnel attached to finance or production department. Indeed, all the departments of any enterprise are interrelated; one is influenced by the other. Evidently, if the ever-presence of reciprocal relationship and their impact as such goes unattended, any endeavour to achieve successful co-ordination is likely to be fruitless.

4. *Continuity:* Co-ordination is not a once for all exercise, rather it is an on-going activity. Indeed day-to-day functioning of the organisation would require conscious managerial efforts in internal and external integration, balancing and synchronisation of purposes as well as efforts.

Considerations in Co-ordination

The following considerations are important for effective co-ordination:

(1) Managerial policies are formulated in a manner that helps to achieve company goals through unified action.

(2) Policies are interpreted properly by the executives.

(3) Organising efforts such as division of work are compatible with the objective of achieving an effective co-ordination.

(4) Management forms a sympathetic, rational and co-operative attitude.

SELF-TEST QUESTIONS

1. "Committee does not represent a separate type of organisation". Discuss.
2. Critically evaluate the uses and the abuses of committee in an organisation.
3. "Co-ordination is sine qua non of organising an enterprise". Discuss.
4. Briefly discuss the various techniques of co-ordination.
5. "Effective Co-ordination is a matter of judicious application of general principles". Discuss.

Suggested Readings:

(1) Principles of Management — *Koontz and O'Donnell*

(2) A Management Source Book — *Franklin G. Moore*

(3) Modern Management — *David R. Hampton*

(4) Management — *Stoner and Wankel*

STUDY XIV

MANAGEMENT OF CHANGE AND ORGANISATION DEVELOPMENT (O.D.)

MANAGEMENT OF CHANGE

Introduction

In an open-system context it is not difficult to analyse behaviour of people subject to the influence of a variety of forces—both internal as well as external—which may necessitate change at individual, group and organisational levels. While change is a fact of life so is individual, group and organisational resistance to change. Since organisational success lies in operational adjustment to, if not influencing the forces of change, it becomes imperative that the managers be aware of and apply appropriate techniques of managing change, such as Lewin's Three-step Model, Action Research and organisation development, with a view to achieving fullest benefits of change and avoiding the dysfunctional consequences.

Meaning of Change and its Causes

Change is a natural phenomenon. Organisation is an open system and is influenced by change in its internal as well as external environment. Management decisions regarding matters like organisation structure, corporate objectives, policies and strategies should not be regarded as final for success and survival of the enterprise, it is necessary that management anticipates change and effectively deals with it.

Change may be defined as a variation in the established way of life to which people are accustomed to in the organisation. Change basically results from stimuli—both outside and inside the enterprise. It can be natural, such as growth of an organism; re-active, such as a forced adjustment to change in technology or practice, introduction of a new employee-benefit scheme with a view to enhancing personnel satisfaction and productivity. Particularly, in an organisational context, in view of the inevitability of change, managers have two options: either to wait until the moment when change is thrust upon the organisation, or to voluntarily initiate steps to bring about the necessary change, or to prepare the organisation to strengthen its competencies in anticipating, planning and implementing change. In any case, there could be a need to identify the various internal and external forces acting as stimulants to change.

A. External Forces: These lies in the external environment of an organisation. They may be classified as:

1. *Educational and Cultural Forces* — Spread of education, changes in the system of education, patterns of culture and so on.
2. *Economic Forces* — Shortage of vital resources, rapid growth of population, market demands, increase of competition, expansion of transport facilities, etc.
3. *Technological Forces* — New techniques of production, improvement of an existing resource, discovery of a new machine, etc.
4. *Political Forces* — Change of government, change of policies of the existing government, spurt in trade union activity, etc.

5. *Social Forces* — Changes in the modes of living, habits and customs, urbanisation, spread of provincialism and racialism.

B. Internal Forces: These are the pressures arising within the organisation. They include

1. Composition and policy of top management;
2. Changes of personnel due to retirement, resignation, promotion, transfer and so on;
3. Change of physical facilities like shortage of supplies of raw materials, wearing out of machinery and equipment, demand for more space;
4. Changes in employee attitudes, feelings and aspirations;
5. Changes in work allocation, duty hours, composition of work groups, and so on.

The forces are inter linked and react on each other.

Resistance to Change

Well documented findings from studies of individual and organisational behaviour have revealed that organisation and their members resist change. And this resistance can be overt, implicit, immediate or deferred. As for example, while threat to go on strike is an overt expression of resistance to change, increased errors or mistakes is an implicit resistance to change. Likewise, resistance to change may be an immediate response or it may be deferred and stockpiled. While resistance to change is not always dysfunctional, rather at times it can contribute to better decision-making and can be a source of functional conflict, it often obstructs beneficial changes. Hence, management needs to identify the sources of individual and organisational resistance to change.

Why Change is Resisted?

New policies and programmes often meet with resistance and cause a failure, unnecessary delay or distortion in implementation. Conflict between human reaction to change and the increased need for change is the most perplexing problem in the management of change. Following are usually identified as the more important factors responsible for people's resistance to change:

(i) People find it easy to do what they have been doing and find it inconvenient to learn something new.

(ii) Since change almost invariably brings with it a redistribution of power and influence, it tends to be opposed by those individuals and groups who are negatively affected by it.

(iii) Change is also resisted when people in course of doing or learning a new system experience failure.

(iv) Change is also resisted by individuals who are less educated and less intelligent, and who rely heavily on their personal experience and are not inclined to take risks. Those who stand to lose the most by the change tend to oppose it the most. People with traditional temperament know that change will expose their inadequacy and inefficiency, and, as such, they must oppose change.

Types of Resistance to change: Resistance to change is of three different types.

These types work in combination to produce each employee's total attitude towards a change. These are

(1) *Logical* — This resistance arises from the time and effort required to adjust to change. These are true costs borne by the employees. It involves rational objections such as: time required to adjust, extra effort to relearn, economic, cost and doubtful technical feasibility of change.

(2) *Psychological:* It is "logical" in terms of attitudes and feelings of individual employees about change, such as fear of unknown, low tolerance of change, dislike of management, need for security, etc.

(3) *Sociological:* It is logical in terms of group interests and values. Social values are powerful forces in the environment, so they must be carefully considered.

While individuals do resist change, it is not difficult to visualise that even groups as well as overall organisations actively resist change. Group resistance and organisational resistance to change may be due to and in spite of individual resistance to change. To illustrate group resistance to change one may cite examples of group norms, values and informal role prescriptions. An individual union member, for instance, may be willing to accept changes in job suggested by management; but if union norms dictate otherwise, he is likely to resist. Indeed, if the proposed change is likely to alter the existing informal group-composition, it would most likely face active resistance.

Sources of organisational resistance to change may lie in such factors as limited focus of change, structural inertia, threat to established resource allocations and power relationships. For example, if the proposed change in one aspect of organisational functioning does not account for its implications for other areas that might be affected, it is likely to be nullified; or when a stimulus to change is counterbalanced to sustain stability as the organisational structure has built-in ways and means of retaining equilibrium or when there is modification in departmental budgets or resource allocation; or when existing power relations are altered by redesignation of functionaries.

Overcoming Resistance to Change

Resistance to change is likely to be minimised if the management help employees to adjust to contemplated change with a supportive conduct and behaviour. The imperative need is to make the employees feel that their interest in the work situation is being adequately considered and fully protected by the management. It should be impressed upon the employees that in the long run they will gain from change and the management will, by all means, help them to achieve these gains. If the supportive climate exists, the employees are likely to be more receptive to change. However, that apart, the following considerations should further be kept in view:

(i) The nature of change should be properly understood with all its ramifications by those who are affected by it.

(ii) Changes should be introduced by stages; further change should be introduced when the earlier change has been fully assimilated.

(iii) Change should not cause security problems to the employees.

(iv) Change is more effective if it is developed after due participation by all concerned.

(v) Change should be properly planned.

(vi) As far as possible, change should not carry individual overtones.

(vii) Display of effective leadership skills and proper motivation of employees will help management minimize resistance to change.

(viii) Introduction of change should be supplemented by systematic training of personnel. Sensitivity training can also be very useful to overcome resistance to change.

(ix) Advice to specialized staff may be sought while introducing change.

(x) Possibility of introducing change through outside management consultant may also be explored.

Concept of Flexibility

Too much flexibility will encourage the subordinates to bypass the existing lines of authority and responsibility and overlook the existing procedures. Too much rigidity on the other hand, makes introduction of change an extremely difficult proposition. The two extremes should, therefore, be avoided. Management should endeavour to strike a proper balance between them. Principle of flexibility and its inevitability needs to be clearly explained and taught to personnel in the organisation. If individuals view change as a matter of routine, problems in managing change will be considerably reduced.

Simulating Participation

Planning for change and its implementation is a challenging job. If disclosed abruptly, change may lead to considerable opposition and resistance. If change is introduced gradually and through participation of affected groups, it is likely to promote understanding and commitment of subordinates to change. A manager can use his leadership quality to dispel any conflict and misunderstanding in the course of participation proceedings for change.

Small conferences and group meetings should be arranged to stimulate participation and enlist co-operation. Managers should explain and discuss the proposed change with people affected by it. The object here is to know what the people think about it and the kind of problems they see in the change. People should be encouraged to ask questions and discuss things logically. Leaders of informal groups should also be taken into confidence while effecting change. Involvement of the people in the proposed change makes them understand and appreciate the need for change. In any case, resistance to change is definitely reduced.

Managers should also use their directional devices of leadership, motivations and communication to develop acceptance to change. Sensitivity training with its psychological fervour can also be used to overcome resistance to change.

Change through the Management Hierarchy

Minor changes are usually introduced by the executive in charge of the activities. However, major changes are finalised and implemented by top management with the aid of lower levels in the management hierarchy. Subordinates comply with orders

and instructions of the senior executive with regard to implementation of change because they view it as his legitimate right.

The hierarchical approach to managing change does not pay sufficient attention to facts like group dynamics, role prescriptions, value structure, and motives and attitude of people affected by change. For its success, it is thus necessary that top management must feel highly committed to the change and take every possible precaution to ensure its success.

In a number of organisations separate specialised planning units are maintained. The staff unit is also frequently used to recommend change and implement it through the line hierarchy.

Some companies prefer to administer change with the help of outside management consultants. The outside consultant normally commands specialised skill and experience. His recommendations can be dispassionate and objective. It is also observed that people show less resistance to change when recommended and managed by an outsider than that initiated and administered internally.

Lewin's Three-step Model

Kurt Lewin argued that successful change in organisations should follow three steps. Unfreezing the status quo, movement or changeover to a new state, and refreezing the new change to make it permanent. Successful implementation of change, thus, should first facilitate unlearning by increasing the 'driving forces' which direct behaviour away from the status quo (equilibrium state) and decreasing the 'restraining forces' which hinder movement from the existing equilibrium. Once the desired change has been introduced, the same needs to be refrozen so that it can be sustained over time. This would require rebalancing of the driving and restraining forces.

Action Research

Action research is a method of scientific inquiry into the circumstances necessitating change and the action that may be taken thereon. It is based on scientific collection and analysis of data and then selection of change action on what the analysed data indicates. The process of action research consists of five steps: diagnosis, prognosis, feedback, action and evaluation. Essentially, this is a problem-focused approach wherein circumstances necessitating change are carefully studied and acted upon. However, in many cases, and this is the way it should be, organisational change is solution-focused, i.e. involving a movement towards better state of affairs thus making the process of change an ongoing, organisation-wide exercise.

ORGANISATION DEVELOPMENT

Introduction

A discussion on organisational change would be incomplete without a reference to organisation development (OD).

Managers of today are deeply concerned with fuller utilisation of organisation's human and other resources for achieving enterprise objectives consistent with human dignity and individual satisfaction. But any endeavour in a fast changing environment is not an easy task. It calls for planned efforts to review organisation goals, develop its new forms, improve technology, planning and decision-making processes,

minimise group conflict, and develop an effective information system. These planned efforts in response to change are commonly described as 'organisation development (OD). This approach differs from the traditional approach of outside management consultants. It is concerned with planned intervention in the organisation and makes use of group dynamics and social psychology techniques. Technical system and social relationships are systematically examined and better solutions developed.

Conditions for Organisation Development

Bennis has laid down the following four conditions that have created the need for organisation development:

1. Rapid and Unexpected Change.
2. Organisation Growth.
3. Increasing Diversity.
4. Change in Managerial Behaviour.

The above conditions lead to diversity and complexity thereby creating the need for change in organisation. An organisation built on bureaucratic model is ill-adapted to rapid change. However, for survival and growth of the enterprise it is essential that the manager should make himself and the organisation viable and receptive to changing environment. New information, beliefs, attitudes, values and organisation structure are required to be adapted to changing environment. There is yet another aspect of the need for organisational change. Unilateral changes introduced by the management are usually resisted by people in the organisation. Especially when changes may be successfully introduced and employee's co-operation enlisted, it is essential that change should be systematically developed. Consultative and participative techniques used in organisation development programme produce better employee understanding and improve organisation performance and results considerably.

Organisation Development Defined

Organisation development is still an emerging field and new methods are constantly being invented and tried. Since a number of approaches and strategies are employed by consultants in effecting planned organisation change, there is no wonder if the concept of organisation development is fraught with complexities. However, the following can serve as a workable definition.

Organisation development (OD) is a long-range effort to improve an organisation's problem-solving and renewal processes, particularly through a more effective and collaborative management of organisational culture—with special emphasis on the culture of formal work teamswith the assistance of a change agent, or catalyst, and the use of the theory and technology of applied behavioural science, including action research (French & Bell).

Planned Organisational Change

Organisation development is characterised by planned organisational change efforts. It involves orderly attempts to identify the problem, diagnose the organisation, develop strategies for improvement and material resources fundamental to this purpose. The variables usually considered by a programme of organisation

development are the values, attitudes, organisation culture and team development. It should be remembered that changes to be effected are connected with those requirements of the organisation which it is attempting to cope with. Moreover, organisation development efforts attempt to change the 'system' as a whole-such as team development, management strategy or record system. The system does not necessarily imply total enterprise.

Top Management Commitment to Organisation Development

Managers at the top must have knowledge and feel committed to the objectives of organisation development programme. Since OD efforts are intended to make organisations more effective and viable to change, top management should be interested in the programme and its outcome, and effectively support efforts in this direction. In fact, success of OD is influenced a great deal by the degree of mutual trust and collaborative relationships between the change agent and management of the enterprise.

Increase in Organisation Effectiveness

A number of criteria have been prescribed by different writers to characterise an effective organisation. Internal flexibility, effective communication, integration and commitment to organisation goals, and high morale and motivation are some of the important sign posts of an organisation in good health. Organisation effectiveness is also described in terms of its ability to adapt and cope with the changes in environment. Since OD effort aims at increasing organisation effectiveness, the interventionist can gain a lot by knowing what a healthy organisation should be like.

Planned Intervention

Organisation development calls for planned intervention in the existing organisation and help it to become more viable. This requires examining its present working norms, value and possible areas of conflict, and developing alternatives for its better health. The interventionist needs to diagnose different sub-systems of the organisation and their processes. On the basis of certain assumptions he develops a strategy for systematic improvement of the organisation. The important areas of intervention are planning and decision-making processes, goal setting, team development, organisation structure, values and cultural norms, organisation culture, and upgrading employee skill and abilities.

Bennis is of opinion that change agents for the most part are external to the organisation and that internal change agents are very few. This is particularly true in the early stages of organisation development effort. Because of their skill and ability to see the problem more clearly and in a detached manner, the external consultant can better manage to effect planned change in the organisation.

Social Philosophy as a Norm of Change

Bureaucratic model of organisation tends to ignore the basic human factors and thereby reduce organisational effectiveness. The consultant, therefore, uses the behavioural science knowledge and develops a system which is more human and democratic.

Characteristics of Organisation Development

(1) *Focus on the Whole Organisation:* OD attempts to develop the whole organisation so that it can respond to change effectively. OD is a comprehensive programme that is intended to assure that all parts of the organisation are well-coordinated.

(2) *Systems Orientation:* OD is concerned with interactions of various parts of the organisation as they affect each other. The basic issue to which it is directed is: How do all of these parts work together to be effective? Emphasis is on how the parts relate, not on the parts themselves.

(3) *Use of a Change Agent:* OD uses one or more change agents who are people with the role of stimulating and co-ordinating change within a group. The change agent may be internal or external.

(4) *Problem Solving:* OD emphasize on solving problems rather than to discuss them theoretically. This focus on real, on going problems is called action research.

(5) *Learning by Experience:* In OD programmes participants learn by experiencing in the training environment the kinds of human problems they face on the job. Participant's experiences help solidify, or refreeze new learning.

(6) *Group Processes:* OD relies on group processes such as group discussions, inter-group conflicts, confrontations and procedures for cooperation. There is an effort to improve interpersonal relations.

(7) *Feedback:* OD relies heavily on feedback to participants so that they have concrete data on which to base decisions. Feedback encourages them to understand a situation and take self-correcting action.

(8) *Contingency Orientation:* OD is usually said to be situational and contingency-oriented. OD is flexible and pragmatic, adapting actions to fit particular needs.

(9) *Team Building:* General goal of OD is to build better teamwork throughout the organisation. Both small and large group teams are emphasized. OD attempts to tie all the groups into one integrated, cooperative group.

Goals of Planned Interventions

The important goals of change agents in organisation development are as follows:

1. To inculcate social philosophy in the organisation and emphasise the need for moving away from the close system to open system.
2. To supplement authority, obedience and hierarchical role with knowledge and competence.
3. To create conditions so that conflict is brought out and managed, it calls for building mutual trust and confidence.
4. To change structure and roles consistent with accomplishment of goals.
5. To encourage sense of ownership in organisation goal.
6. To locate decision-making close to the source of information and action.
7. To lay emphasis on feedback, self-control and self-direction.

8. To build spirit of co-operation, mutual trust and confidence.
9. To develop a reward system based on recognition of achievement of goals of the organisation and development of people.

Stages in Organisation Development Effort

OD effort progresses through a series of definable stages:

1. It is a planned change effort involving a diagnosis of the organisation development plan for improvement and of resources.
2. Organisation wide the effort is related to total organisation change such as change in culture, reward systems.
3. It is managed from the top. Top management takes interest in the programme and results.
4. It increases organisation effectiveness and health. Managers manage their work against goals and tasks. Decisions are made near sources of information. Communication is undistorted.
5. Planned intervention, intervention based on behavioural science are used and these cover ways of work culture norms, perception, motivation, relationships and conflict management.

In general the following steps are involved in OD efforts:

(i) *Identifying and Diagnosing the Real Problem:* Before a strategy for planned change is developed, it is essential that the OD practitioner should know the real problem and diagnose it. The system where change is pertinently required, its relation to other units in the organisation should be thoroughly examined. The underlying social relationships deserve more attention. Diagnosing process frequently requires use of some form of employee survey and feedback system.

(ii) *Development of Strategy:* Once the problem is identified and diagnosed, the next step in the OD programme is to determine the strategy most appropriate for organisation's better health. While determining the organisation development strategy, specialists should decide about the units of organisation requiring concentration—individuals, sub-systems and the total system. The change agent should also build-up sufficient interest and secure internal support for the programme.

(iii) *Implementation of the Programme:* OD programme may well be tried to a part of the organisation before it is used for the whole of the concern. Moreover, if the programme involves change of orientation and improvement of skill, OD expert should suggest or arrange for change of orientation and training of the employees either within the enterprise or outside it. Sensitivity training is of great help in improving understanding and skill in practice, in self-awareness, interpersonal relationships, conflict and group dynamics.

(iv) *Reviewing Progress of the Programme:* The OD practitioner may himself evaluate the result of the organisation development effort. But it is better if results of the programme are reviewed by some qualified persons not involved in developing the programme.

Organisation Development, Management Development and Operations Research

Organisation development should not be confused with style of leadership or any form of decision-making. Its primary concern is improvement of systems and sub-systems through planned intervention and change in the existing organisation by making use of behavioural science knowledge. Sometimes organisation development is confused with management development which is virtually development of the managers. Management development is concerned with upgrading the managers' skills and abilities whereas organisation development, though including management development, is primarily concerned with improving the total system constituting the organisation. In the same way, organisation development is not the same thing as 'operations research' in spite of the fact that both these contain a number or similarities. Both organisation development and operations research are problem-centered and lay emphasis on improvement and optimisation of performance. In each of them the stress is on systems approach to the problem, and both of them are effective in organisations characterised by rapid change and complexities. However, operations research is largely based on selection of qualifiable variables, whereas organisation development programme is more concerned with human values and factors like group collaboration, conflict management, team development, communication system, and the like. A proper relation and co-ordination between the two, both at the top management level and also at the operative level, can be of tremendous help in improving organisational effectiveness.

In a large organisation, any change to become operative and maintainable, normally consumes a period of two years or more. During this transition period management has to pass through difficult, painful and frustrating time. In order that the changed programme may succeed, it is thus essential that there must be an obvious commitment to an extended time on the part of the organisation leaders.

OD efforts usually lead to systems that are significantly different from and violative of the existing system. OD practitioner should, therefore, be fully prepared to meet resistance to change successfully. Unfortunately, some interventionists follow the policy of playing down the differences in values and behaviour on the assumption that these will go with the passing of time. But it is in conflict with his own values. It is likely to create the credibility gap. A better policy, as such, would be the willingness to accept genuine resistance to change. He should be authoritative without being authoritarian and let the organisation leaders feel convinced of his worth.

SELF-TEST QUESTIONS

1. Clearly bring out the relationship between organisational change and organisational development.
2. What are the various levels of change likely to be necessary in an organisation. What type of resistance do the managers have to face at each of these levels?
3. Discuss the various forces of change operating within and outside the organisation.
4. Given the inevitability of change and so its resistance, how would you

overcome people's resistance to change?

5. Discuss OD as an intervention for planned change.

Suggested Readings:

(1) Modern Management — *David R. Hampton*

(2) Management — *James A.F. Stoner and Charles Wankel*

(3) Organisation Development — *Wendell L. French and Cecil H. Bell*

(4) Organisation Development: Its Nature, Origin and Prospects — *Warren G. Bennis*

(5) Human Behavior at Work — *Keith Davis*

(6) Management of Change and Conflict — *John M. Thomas and Warren G. Bennis*

STUDY XV

DIRECTING AND COMMUNICATION

DIRECTING

Introduction

In addition to planning, organising and staffing, every manager must also direct his subordinates. An enterprise may have well knit and co-ordinated plans; may have properly laid out activity-authority relations; and further be manned by properly selected and able personnel; yet a manager must initiate organised endeavour so that plans are translated into effective action and enterprise objectives accomplished through group efforts with minimum of inputs and unsought consequences. Directing is thus the initiating function of management that actuates plans and the organisation. Just as starting the motor of a car does not make it move unless put into gear and the accelerator depressed, in the same way organised actions are initiated in the enterprise only through the directing function of management.

Directing is an important function of management which involves communicating and providing leadership to the subordinates and motivating them to contribute to the best of their capability for the achievement of organisational objectives. It is concerned with influencing the behaviour of human resources for the accomplishment of organisational objectives. Directing concerns the total manner in which a manager influences the actions of his subordinates. It is the final action of the manager in getting others to act after all preparations have been completed. It starts with issuing orders and instructions to subordinates and ends with getting things done by satisfaction of various needs of subordinates.

Essential elements of the directing function of management are:

(i) Issuing orders and instructions.

(ii) Guiding, counselling and teaching the subordinates the proper way of doing the job.

(iii) Supervising the work of subordinates to ensure that their performance conforms to the plan.

(iv) Motivating the subordinates to direct their behaviour in a desired pattern.

(v) Maintaining discipline and rewarding effective performance.

Directing does not cease merely with issue of instructions and orders. In order to direct his subordinates, the manager must communicate with them, devise suitable system of motivating them and carry them with him through dynamic leadership. Moreover, directing function cannot be performed in isolation. It must be exercised in conjunction with all other functions of management.

Further, directing is a continuous function performed by managers at all levels of the organisation. Thus, a supervisor or the foreman must direct the workers just as the chief executive is to direct his immediate subordinate managers. However, the time and efforts spent by the manager in his directing function tend to increase as one goes down the levels of organisation.

Principles of Direction

Taylor pointed out that effective direction depends upon the “harmony of objectives”. Any enterprise may bring prosperity for itself and its employees giving adequate attention to this principle.

Henri Fayol emphasised certain other concepts to facilitate direction which he viewed as commanding. These concepts are to (i) have a through knowledge of the personnel; (ii) eliminate the incompetent; (iii) be well versed in the agreements binding the business and its employees; (iv) set a good example; (v) conduct periodic audit of the organisation and use summarised charts to further this; (vi) bring together the chief assistants by means of conferences at which unity of direction and focussing of effort are provided for; and (vii) aim at infusing unity, energy, initiative and loyalty among the personnel.

Mary Parker Follett added a few more fundamentals governing the principles of direction. They are (i) a good amount of training and education within the organisation to shape the attitude of the employees; (ii) minimum possible distance between the origin and destination of the order; (iii) reconciliation of conflicting attitude for reluctant compliance with directions; and (iv) depersonalised orders to obey the boss of the situation.

In the light of the above and recent developments, the principles of direction may be enumerated as follows:

1. *Harmony of Objectives:* The most significant principle of direction is to harmonise the objectives of the individuals, the groups and the enterprise. Synchronisation of varied objectives is a must with a view to securing maximum prosperity for the employers as well as the employees. Taylor emphasised this view to make any direction effective. In his opinion, interest of any individual or group of employees should not prevail over that of the organisation.

Henri Fayol pointed out that there should be subordination of individual interest to general interest. Organisation should devise and introduce effective measures to reconcile the conflicting interests. He further asserted that if orders go direct to subordinates, this will help maintain a unity of view among the employees with respect to enterprise objectives. But if the orders go through a series of intermediaries, divergent views relating to objectives of the enterprise are likely to come up. It is evident, therefore, that direct communication has an important bearing on harmony of objectives.

2. *Unity of Command:* This principle requires that an employee should receive orders from one superior only. In other words, it signifies a unified system of directives, instructions and other devices for enforcing command or direction. This principle is based on the premise that a man cannot shoulder dual or multiple command.

It may be noted that in the absence of division of loyalties, problems of priorities and conflicting interest, subordinates work well.

3. *Unity of Direction:* Unity of direction essentially signifies the existence of only one head and one plan for a group of activities which have the same objective. It should be noted, however, that unity of direction and unity of command are not the same thing. Unity of direction results from sound organisation structure, whereas unity of command leads to effective functioning of the subordinates. “Unity of

command cannot exist without unity of direction, but does not flow from it" (Fayol).

4. *Direct Supervision:* Any endeavour in directing becomes more effective if it is accompanied by personal touch. Subordinates feel happy and a sense of participation is inculcated in them if the seniors maintain direct contact with their juniors. Such relationship undoubtedly motivates them for effective functioning and thus direct supervision may be considered one of the best ways to get things done by others.

5. *Democratic Leadership:* In order to make any direction effective, the leader should have respect for the opinion and views of his followers. He should ensure their participation in matters related to their job, functioning, working environment and so on. As a result, seniors can secure maximum contribution from their subordinates in the accomplishment of the designated tasks.

6. *Follow-up:* It is to be remembered in all situations that direction does not mean simply issuing orders and instructions and through them getting the things done within the stipulated time. In order to make direction effective, executives and managers should not only instruct their subordinates but follow up the work. It should be the duty of the seniors to oversee the working of subordinates, check their performance, guide them to follow the right course of action, point out their deficiencies, suggest the ways and means to develop the work methods and change the mode of directing if circumstances necessitate.

In short, these are the principles of direction which seniors should follow to achieve effective result from directing.

Means of Direction

The two important means of direction are

(i) Orienting the employees.

(ii) Issuing orders and instructions.

Orientation: New employees are generally introduced to the environment of the enterprise, its present and immediate future activities, physical facilities, the work that an employee is expected to do and its relation to other jobs in the organisation, and also the details of employment. However, orientation should be viewed as a continuing necessity. Employees should be constantly briefed about their new assignments and changes in enterprise activities and objectives and their achievements or failures.

Issuing Orders: Orders are very important in directing subordinates. Since orders are frequently used in manager's daily routine, it is necessary that he must possess sufficient knowledge and skill in formulating and issuing them properly.

Though directives are issued almost everyday by the managers, they tend to avoid using the term order or command because of its military or dictatorial overtones. More often they use such terms like suggestions and requests in place of orders. But this attitude on the part of a number of managers does not reduce the basic character of an order. As a directional technique an order may be defined as the command of a senior directing a subordinate to act or to refrain from acting under a given situation. An order should be so framed and issued as to contribute to the accomplishment of the enterprise objectives.

Depending upon the need of the situation a manager may issue written orders or oral orders. A written order forces the manager to give serious thought to the problem and can be transmitted to all concerned. A written order shields the subordinates against the risk of executing a task exceeding their authority. It also assures the manager against the possibility of subordinates attempting to circumvent the directive. But written orders usually prove more rigid and costly than the oral orders. However, to be more effective an order, written or oral, should possess the following characteristics:

(i) Subordinates should be able to understand it.

(ii) It should be reasonable and capable of compliance.

(iii) The order should be consistent with objectives of the group.

(iv) It should be properly worded and should not be offensive.

If an order is vague and incomplete, it may be interpreted differently by concerned officials who may be incharge of its implementation. Where time is of essence and no time limit is prescribed by ordering authority, completion of the task may be delayed. An order which cannot be implemented by the person for whom it is meant, will lead to lack of interest, bitterness and demoralisation. The ordering authority should see not only the task but also the people who are responsible to perform it.

Approaches to Direction

Directing is the initiating function of management. The manager should direct the efforts of the subordinates so as to ensure the optimal individual contribution group objectives and harmonise the attainment of individual objectives with the accomplishment of group goals. For this purpose, he should select that approach which will motivate the subordinates to contribute their maximum to the accomplishment of the enterprise objectives. The approach to be followed in directing the subordinates will largely depend upon the personal qualities of the subordinate, his personal traits and the situation with which he finds himself involved. The three basic approaches followed by the managers are:

(i) consultative,

(ii) free rein, and

(iii) autocratic.

Consultative or participative technique makes use of inviting suggestions from the subordinates before issuing them instructions. The free rein technique allows the subordinate substantial freedom to use his own skill and initiative in solving the problem. The autocratic approach results in the development of rigid, precise and comprehensive instructions to be followed by the subordinate without much scope for individual initiative. Complete autocratic and free rein techniques of direction are the two extreme approaches. In order to be more successful in directing his subordinates, the manager should bring about proper balance between these two opposite positions. Depending upon the situation faced by him at a given time, even the most participative manager may find it more advantageous to issue autocratic command. In the same way, there are occasions when even the most autocratic manager should prefer to use consultative approach while directing the efforts of his subordinates.

General Considerations

While directing the subordinates the manager normally attempts to achieve coordination through their co-operation. A subordinate is found more willing to extend his cooperation if he understands his share in the attainment of group goals. The manager should therefore, properly communicate what each subordinate under him is expected to do and how his efforts contribute to the accomplishment of group goals. In the same way, authority relations should be clearly defined and as far as possible the principle of unity of command should be adhered to. This will avoid confusion to a great extent and reduce the possibility of conflicting orders being issued. In addition, the manager will be more effective in directing if the existing policies, procedures and practices are known to the subordinates. Subordinates should also understand the purpose behind the directives issued to them. Nevertheless, effective direction requires some amount of personal contact which the manager should not overlook.

COMMUNICATION

Nature of Communication

Communication is a vital aspect of the managerial process. In fact, superior-subordinate relation cannot thrive without effective and meaningful communication. Effective communication is often defined as the exchange of thoughts, facts, opinions, or information by two or more persons so as to bring about mutual understanding or confidence. Communication may be through words, symbols, letters, or actions. But so long as people in the organisation share the meaning and understanding with one another, there is communication. To be more specific, communication may be defined as the transfer of information and understanding from one person to another. There thus exist two indispensable features of communication:

(i) Communication cannot take place till there are at least two persons - receiver and the sender.

(ii) Communication need not elicit confidence, but the information which is so exchanged must be understandable to the receiver. There can hardly be any communication if information is not understood as it was intended to be. However, understanding does not mean that the receiver must agree to the information. Communication has taken place when the information is understood even though there is disagreement.

Importance of Effective Communication

Communication is all pervasive and influences every function of management. In order to get the things done through and with the efforts of others, every manager must communicate. In fact, success of all managerial functions largely depends upon effective communication. Effectiveness in managing largely varies with the ability to communicate. Planning does not take place without information about alternative strategies and their consequences. It is only with effective communication that different policies and programmes can be properly formulated and executed. Good communication is also very useful in ironing out differences and misunderstandings and thus brings forth confidence. Communication further helps the manager to determine whether planned goals are achieved and to what extent actual performance deviates from the standard.

Within the organisation, communication is concerned with effecting change or influencing actions. Communication helps to bring the people together and work for accomplishment of common goals. It is through communication that the manager must secure the willingness to serve and also assess the ability to serve. Change is better managed through exchange of information and understanding. The manager must influence subordinates to work with zeal and confidence and build a highly motivated team of subordinates. All this involves communication. Thus communication is vital to all phases of management and deserves the fullest attention of managers.

Communication is the force that leads the people of an organisation. It builds up team work and morale. Communication influences every object of social or group activity. In fact it is a very complex type of behaviour.

The Communication Process

The communication process consists of a series of steps by which a sender reaches a receiver with a message. It involves six steps:

(1) *Develop an idea:* This is the idea or thought which the sender wishes to transmit. This is the key step, because unless there is a worthwhile message, all other steps are somewhat useless.

(2) *Encode:* In this, the idea is encoded with suitable words, charts, or symbols for transmission. At this point, the sender determines the method of transmission.

(3) *Transmit:* The finally developed message is transmitted by the method chosen. Senders also choose certain channels and communicate with careful timing. Senders also try to keep their communication channels free of barriers.

(4) *Receive:* Clear reception of message is a condition precedent to its effective interpretation, storage and use. In an interpersonal mode, it would involve attentive listening.

(5) *Decode:* Step five is to decode the message so that it can be understood. The sender wants the receiver to understand the message exactly as intended. Let, due to different perceptions of two different people, the receiver may not understand exactly what the sender intends. The more realistic goal in most situations is for creating communication to become successful.

(6) *Use:* The last step is for the receiver to use the communication. He may ignore it, perform the task assigned, store the information provided, or do something else.

Principles of Communication

As has been emphasised by Koontz and O'Donnell, the principles are fundamental guide to sound communication. In their words, "their direct attention to four critical areas; message quality, conditions for reception, maintenance of integrity of organised effort, and taking advantage of informal organisation". The principles laid down by the two management experts may be analysed as follows:

1. *Principle of Clarity:* To make any communication effective, the primary responsibility rests on the shoulders of the transmitter in the sense that communication possesses clarity which can be achieved through clear, simple and easily understandable language. While communicating, the transmitter should always keep in view the education and experience of the receiver, familiarity with the language, otherwise the very purpose of communication is likely to be foiled. Any communication to be completed must be understood and attended by the receiver and in response to that his views, ideas and opinion must also be transmitted. Essentially, it is a matter of overwhelming significance how the message is composed to help the receiver understand and attend it and respond in turn. Attention to clarity as such should obviously be considered a prerequisite to effective communication.

2. *Principle of Integrity:* Communication is a means and a tool for securing and maintaining necessary co-operation between superiors and subordinates for the accomplishment of enterprise objectives. In view of this, attention needs be directed to the positions of subordinate managers or executives who should be encouraged to use their positions for this purpose. But it is not infrequent to notice that superiors send messages by passing subordinate managers in an effort to contact the employees directly. The attitude cannot be considered reasonable and judicious except under circumstances when simultaneous communication is essential or where the message is of equal concern to both subordinate managers and employees of the enterprise.

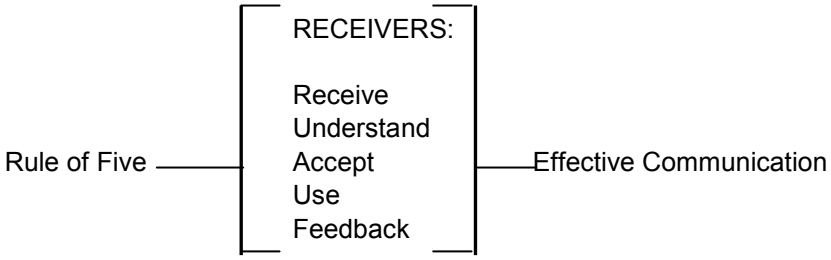
3. *Principle of Strategic use of Informal Organisation:* This principles signifies that to make communication effective managers and executives shall utilise the informal organisation to supplement the communication channels of the formal organisation. Informal organisation originates from people's desire to exchange information. Since such organisation grows spontaneously, managers and executives should utilise it to transmit and receive communications to supplement those of formal organisation. Indeed, such attempt would foster and ensure co-ordination of enterprise efforts.

However, it needs to be mentioned in this context that principles of communication cannot be enforced. The underlying impact of effective communication is to be felt by all concerned of any organisation. They as such, have to develop an understanding of the principles and a zeal to apply these in their bid to communicate. Lack of communication or poor communication undoubtedly affects understanding of the employees, hinders their willing co-operation, puts co-ordination out of gear, thus deprives the organisation of efficient and smooth functioning.

The Rule of Five

Two additional receiver steps are desired by senders, but they are not essential to complete a communication. These are: acceptance of communication by receiver and feedback to the sender regarding it. Acceptance of communication improves cooperation and motivation. Similarly, feedback tells them how well the message is understood and how it will be used.

The entire set of five receiving steps in communication often is called the rule of five, as shown in the figure given below:



Channels of Communication

The numerous channels through which information flows from person to person throughout the organisation constitute the communication network for the enterprise. The important elements of such a network are:

(i) determining the information to be communicated and the person to whom it is to be communicated;

(ii) transmitting information accurately and at appropriate times;

(iii) processing and interpreting the data before retransmitting the information; and

(iv) maintaining records and information till required.

The two distinct phases of communication network are the official channels of communication and the informal communication.

Formal Channels of Communication

Formal channels of communication are established mainly by the organisation structure, and are referred to as “communication through the chain of command”. While developing a communication network, the primary attention should be directed towards determining the degree of reliance to be placed upon the formal channels. The reason is that official channel has traditionally been used as the chief avenue for communication.

Formal channels of communication provide for both vertical and horizontal flow of communication. Vertical communication flows downward as well as upward. While directing activities of his subordinates, the manager issues instructions and orders and transmits information down the levels in management hierarchy. Organisation charts exhibit the flow of authority and the channels through which downward communication must flow. Downward communication is frequently used to direct subordinates and transmit information relating to company objectives, policies and procedures. Upward communication is another aspect of vertical flow of communication. The organisation structure while laying down activity-authority relations not only establishes the channel of command through which the manager transmits directives and information to subordinates but also creates a line of communication for conveying information by subordinates to their seniors. It is through this type of communication that the management can determine whether or not the information transmitted has been received and properly understood. Every manager should encourage free flow of upward communication so that subordinates feel free to transmit their opinion, attitude and action to their seniors.

Vertical flow of communication presents certain difficulties. If every information is transmitted through the official channel of communication, the managers would be

more busy transmitting routine and standardised information rather than doing the creative job of managing and concentrating more on the flow of essential information. The fact is that for better results, routine and standardised information must flow without much of managerial attention. Moreover, communication through channel of command greatly obstructs free and accurate flow of information. Information which is required to be transmitted orally, may contain a degree of error if transmitted through intermediaries. Similarly, while talking to a person in a position of power, the subordinate tends to communicate to his superior what the latter likes to hear. Sometimes, subordinates deliberately distort the information to protect their interest. They are tempted to slant information relating to their failures and over emphasise their success.

There is yet another flow of communication commonly described as sideward, horizontal, or lateral communication. This type of flow is concerned primarily with the transmission of information and understanding between different departments or people at the same level of organisation. Like vertical flows, horizontal flow of communication is also essential for the efficient functioning of an enterprise. It enables executives on the same level of management hierarchy to exchange information and co-ordinate their activities without referring all matters to superior managers. This is sometimes called as a “gangplank”. Matters when handled on the same level of organisation speed up actions and relieve superiors of a number of unnecessary or less important problems.

An important aspect of communication network is that if a rapid flow of information to different people in the organisation is essential for its smooth working, management should sort out information of routine and non-routine nature and develop standard procedures for dealing with routine communication. This will help communication to flow speedily. Standard procedures should also be developed for transferring information from one part of the organisation to another. These standard procedures constitute part of the formal organisation. Standard forms, summary reports and official bulletins also greatly help in developing smooth flow of information throughout the organisation. However, it should be remembered that communication network for dealing with major and non-routine issues tend to be more complex.

The Grapevine

Sociologists and psychologists point out the inherent tendency of the people in the organisation to cut across formal channels and communicate informally. Informal organisation emerges spontaneously within every formal organisation, and along with it grow the informal channels of communication, commonly referred to as the grapevine. Any informal communication about company and personal matters outside the official network constitutes grapevine. Thus, the grapevine consists of a complex network of informal communication taking place all day long on the job. It is characterised by the emergence of spontaneous channels through which facts, half truths, and rumours pass.

Though grapevine is not the result of a deliberative management design, it offers certain attractions for its better use by managers:

(i) The informal network of communication represents natural desire of people in the organisation to interact and communicate with each other and fulfills the subordinate’s desire to know the latest information or event.

(ii) The grapevine works with surprising speed and is often faster than official channels; information gets disseminated very promptly.

(iii) It also offers the managers insight into what the subordinates think and feel.

(iv) The informal network of communication is also useful for disseminating certain information which, in the general interest of the organisation, could not be transmitted through the official channels. Thus, cases that led to sudden resignation of a manager may be communicated through the grapevine without giving members of the organisation the impression that he was the victim of some unfair top management action.

(v) During periods of insecurity and uncertainty, the grapevine gives members of the organisation an outlet to freely express their fears, attitudes and thoughts.

There are also certain negative aspects of the grapevine. Management should take care of these while putting the informal network of communication into use:

(i) Not often the grapevine carries rumours, inaccurate and partial information. Because of personal interpretations and suspicions, information gets distorted.

(ii) Since it is spontaneous the grapevine has no stable associates or definite pattern. Generally, a few persons are usually found active participants in the grapevine. The path and behaviour of the grapevine is also unpredictable.

(iii) The grapevine is based on oral communication where the communicator is not held accountable for the information so transferred by him. The result is that the sender feels free to exercise his imagination and transmit information according to whims and likings. He communicates the information as he understands it. Moreover, with a view to keeping his source unembarrassing or the risk of being cut off in the future, the communicator may withhold certain information. In the same way, consideration of the feeling of listeners also tempts him to transmit information which is pleasant to hear.

The informal network of communication is not established by management and as such it cannot be ordered to be abolished. A manager's attempt to stamp out grapevine is just imaginary and uncalled for. There is no denial of the fact that the grapevine is highly unpredictable and carries with it the danger of spreading rumours and transmitting incorrect, partial and distorted information. But it is also true that the grapevine performs certain useful functions. The manager should, therefore, attempt to make better use. The following considerations can be of help in this context:

1. He should know people in the organisation, their attitudinal and behaviour pattern.
2. He should learn to read the grapevine message which would enable him to know the happenings in the organisation. He should discover the active participants and leaders in the grapevine and attempt to make the information more meaningful and effective through them.
3. Half-truths and rumours should be countered by forceful presentation of facts. Formal channels of communication should also be improved.
4. If in the interest of certain individuals or the organisation some information cannot be transmitted officially through the formal channels, the manager should make effective use of the grapevine for the purpose.

If grapevine is ignored by management then inner feelings and reactions of the subordinates cannot be known. Attempts to suppress grapevine can create tensions and conflicts in the organisation and create very serious problems for management. Managers have found the informal structure more effective than formal provisions.

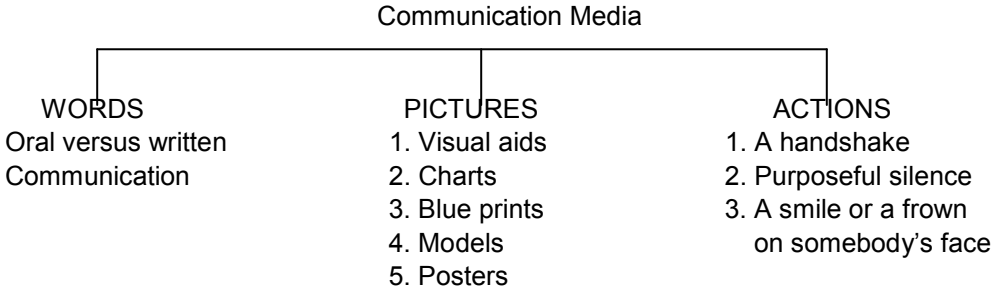
Crosswise Communication

Crosswise communication is also known as diagonal communication which signifies the communication between different departments of equal, higher or lower position. Organisations of the day not only permit but also insist on voluntary crosswise communication to expedite information; transfer and improve understanding since flow of information through regular chain of command is very much time consuming and quality of understanding is also likely to suffer. Crosswise communication may create some confusion and difficulties and affect unity of command. As a matter of fact, certain measures, in all circumstances, must be taken to make any such communication effective.

According to Koontz O'Donnel and Weihrich "Crosswise communication should rest on the understanding that (i) crosswise relationships will be encouraged wherever they are appropriate, (ii) subordinates will refrain from making policy commitments beyond their authority, and (iii) subordinates will keep their superiors informed of their important inter-departmental activities".

Communication Media

Words, pictures and actions are the media used for exchanging information and developing understanding between different persons. The important communication media are indicated below:



Oral versus Written Communication

Words are the most important symbols used in the communication network of the organisation. Information through words can be transmitted orally or in written form. Oral communication as a means for gathering and disseminating information is generally used more extensively than written communication. A considerable part of the manager's time is consumed in personal contacts with subordinates and others. Oral communication offers certain advantages over written communication:

(i) Oral communication possesses the distinct advantage of being quick. Prompt action and dissemination of information can be effected if based on oral communication.

(ii) It provides an opportunity to those involved in communication to respond directly to each other and thus encourages a two-way process of information

transfer. This has the further effect of promoting understanding, co-operation and new ideas.

(iii) As a result of direct contact between the speaker and the listener, disagreements and misunderstandings can frequently be resolved on the spot.

(iv) Oral communication through direct contact gives the subordinates a feeling of belongingness and a sense of personal importance. This adds to his morale and motivation.

(v) Face-to face oral communication enables the superior to judge the reaction of his subordinates to a planned or proposed course of action. This helps him to use leadership and motivational techniques to remove barriers to communication, or to change the orders and instructions so that no resistance is encountered thereafter.

The above discussion of oral communication is not intended to undermine the importance of written communication. Standardised forms with blank spaces for messages and instructions, lingo, summary reports and official bulletins, are all frequently used in organisations for transmitting information and messages. Written communication lacks the plus points of oral communication as outlined above. However, it possesses certain advantages not available with oral communication. Thus, written communication can be more definite and effectively drafted and formulated than the oral communication. Similarly, written communication can be retained as legal records and also as a source of reference. Necessity for written communication is further increased on account of the following complications implied in oral communication:

(1) Oral communication is influenced by self-interest and attitude of the people. Since people tend to notice and care for only those aspects of the situation that effect them or relate to their work, the subordinate may pay little attention to the say of the supervisor if the same does not relate to his work directly.

(2) Problem of personality and reliability of the communication is also important. If, for example, a message is communicated by Mr. X, people may not believe it. But if the same thing is said by Mr. A, people may accept it as correct and reliable. Thus, the image of the communicator in the mind of the receiver is a factor of great significance in oral communication and, at times, it tends, to reduce effectiveness of the message.

(3) Oral communication also suffers from the limitation of being distorted. Possibility of distortion goes up with every increase in the organisational distance.

(4) In oral communication, the message tends to be distorted by the manner and tone of the voice, by the time and circumstances chosen for conveying the message, and also by facial or hand expression. Thus a message may be misinterpreted simply because there was no cordial greeting or because it was communicated under unfavourable circumstances.

Communication through Pictures

Pictures are very powerful communication media. They are visual aids and frequently used for transferring information and understanding to other people. Motion pictures make a tremendous impact upon the audience and furnish a clear

proof of the power of pictures in exchanging information, ideas and facts. Organisation charts portray the organisation structure with basic relationships and groups of positions and functions. It is much more easy to communicate activity - authority and scalar relationships through organisation charts than by words or any other communication media. Pictures create a lasting impression and afford a very convenient and simple way to acquaint the people with information and ideas required to be communicated. Blue prints, drafts, models and posters are some of the important communication symbols used under this heading.

Communication through Action

Actions offer a third type of communication medium. Purposeful silence, manner and tone of the voice, facial or hand expression carry and convey meaning to the people in the organisation. Thus lack of courtesy or a frown on the supervisor's face can be interpreted by the subordinate as criticism of his work. In the same way, a handshake or a smile after the talks are over is usually taken as a symbol of agreement. Purposeful or unexplained silence on the part of the manager is also taken to mean something by the subordinate.

At times and in some instance certain communication media seems better than others. But it is generally a combination of media that is used to share information and understanding.

Computerised information System

Managers of a number of medium-sized and large organisations have gradually adopted improved techniques of electronic computers for processing and reproducing data. Use of electronic equipments has made it possible for management to secure hitherto unavailable information, quickly transfer a mass of information on schedule.

The three major kinds of informational system found in organisations operating under electronic computers are—(1) the financial system concerned with money flow through the organisation; (2) the logistics system involving information about flow of goods through the organisation; and (3) flow of information about personnel. The basic problem in designing informational systems is to translate informational requirements into a form that can be effectively handled by an electronic computer.

A number of claims are made in favour of computerised informational system. Indeed it is very serious problem and deserves management's fullest possible attention. Computer installation should not be motivated simply because it is the talk of the day or because the competitor has installed one. Company operations should be thoroughly analysed to determine how and to what extent integrated data processing can be utilised. Cost or rent of the computer must be favourably balanced by the revenue considerations. Cost of the system should be ascertained in terms of cost of programming, training personnel and making a transition from the existing manual record-keeping to the computer system. The computer system may eventually fetch rich dividend in the form of reducing processing costs with timely and better information; yet it may also impose limitations not present in the non-computerised system. In fact, with better planning and improved skill in handling man-to-man relations in the organisation, a significant part of the total information can be transmitted faster and more economically with the non-computerised system. The possibility and cost of outside centres should also be explored. A number of small, cheap and versatile electronic equipments have also been developed. Management

should carefully analyse the possibility of using them as alternative computer system.

Communication Barriers

Although communication networks have greatly improved in the recent past, yet much remains to be desired. There exist certain barriers to communication that tend to distort the message and directly retard the success of the managers in the performance of their tasks. Poorly transmitted messages lead to misunderstanding and frictions and affect employee morale adversely. A large number of managerial problems are the result of faulty communication. Some of the important barriers obstructing clear understanding and causing break-downs in communication are as follows:

1. Distortion caused by superior-subordinate relationship.
2. The problem of semantic distortion.
3. Barriers arising on account of premature evaluation.
4. Barriers due to perfunctory attention.
5. Barriers due to failure to communicate.
6. Barriers arising on account of resistance to change.

Barriers due to Superior-Subordinate Relationship

One of the fundamental barriers to communication arises from the status relationships in the organisation. The superior-subordinate relationship in the formal organisation structure inhibit free flow of information and exchange of ideas, suggestions and questions.

Thus, a superior being conscious of his position may offer advice and comment on the subject under discussion before listening fully to what the subordinate has to say. Inability or impatience of the superior to listen to the emotional content of what the subordinate is saying also results in failure to understand the true feelings and emotions of the subordinate concerning a particular problem. This will have the further repercussion of adversely affecting his morale and encouraging the subordinate to curtail useful information in future.

The subordinate, on the other hand, assessees the message flowing down to him in terms of his own background, position, experience, and personality of the senior. In doing so he frequently adds motives which were never intended. Thus, the company news bulletin is often termed as a propaganda device and mouthpiece of management irrespective of any factual information contained in it. Similarly, trade union leaders have a strong tendency to attach unintended meanings and motives to a manager's statement. This kind of mental block influences feelings and prejudices and creates a barrier to proper understanding in the organisation.

Barriers to communication arising on account of superior-subordinate relationship are not confined to downward flow of communication alone; obstacles also arise in the upward flow of communication. A confession of mistakes may be good for one's inner satisfaction, but it does not lead to material gains in terms of promotion and pay increases. Accordingly, subordinates slant information relating to their failures and overemphasise their success. An example of this kind of distortion is provided when the supervisor fails to communicate upward the grievances of his subordinates lest it should reflect unfavourably on his ability to guide and supervise them efficiently. In order not to disturb his personal equilibrium with the news liked by the senior, the

subordinates often tends to communicate to the senior what the latter likes.

Semantic Distortion

Messages communicated through works may be distorted intentionally. However, there are words that often mean different things to different people and thus cause non-deliberate distortions. The senior selects the words according to his own frame or reference which he thinks adequate to convey the meaning intended to be communicated. The receiver, on the other hand, reads or listens to the message and interprets it within his own frame of reference. Since people differ in their orientation, experience and knowledge of the language, there is no wonder if communication transmitted through words is distorted on account of semantic problems. Words such as “efficiency”, “profits”, “management prerogatives”, etc. have acquired symbolic meanings that are even more powerful than their literal meaning. Thus, efficiency implies different meanings to an expert, a union leader, a worker, or a manager. In the same way, management may refer to profit as the essential means for survival and growth of the enterprise, while to a worker or a union leader the word ‘profit’ means surplus derived from inadequate salaries. Thus, semantic difficulties come in the way of clear understanding.

Premature Evaluation as a Barrier to Communication

Listening is often described as a good business. In order that the complete message may be transmitted and received, it is essential that the communicator should be provided with an environment in which he can state his full position. It is only when proper understanding has been gained that one should attempt to evaluate communication. Premature evaluation and response tend to stop the transfer of information.

Barriers due to Perfunctory Attention

Communication in the sense of transfer of information and understanding will fail if the receiver pays little or no attention to the message. In colleges, schools, business enterprises, and other organisations as well, failure to read bulletins, notices, reports and minutes is quite common. In the same way, people are usually found paying half-attention to what is being communicated orally. Whatever be the reasons, perfunctory attention to the message makes communication less effective. It is generally found that due to their preoccupation with domestic and other problems people pay more attention to those ideas that directly concern them and which they are expected to hear. Information that conflicts with our established pattern of thought is generally overlooked.

Barriers due to Failure to Communicate

There are managers who fail to communicate correct information at the right time. This is partly because of human tendency to be lazy and partly due to inability of the executive to select what to communicate. In any case, failure to communicate will cause the communication network to break down.

Barriers due to Resistance to Change

Because of convenience, security and other reasons people generally prefer to adhere to the old pattern and tend to resist change. The result is that people welcome

all such information as is consistent with their present belief and attitude. Any communication attempting to introduce change or convey a new idea is thus likely to be overlooked and at times, opposed by the receiver.

Other Distortions of Information

Communication is distorted if the message is not properly expressed. Thus, when information is worded in a manner not understandable to the average receiver, it is likely to be misunderstood. In the same way, when communication is not retained its future transmissions are likely to be less and less accurate. Moreover, if the senior executive is not trusted by his subordinates, communication will be blocked and assigned unintended meanings and motives.

Overcoming Barriers to Communication[1]

Effectiveness in communication greatly contributes to the success of managerial functioning. Essentially, exchange of information and understanding at all levels in the organisation should be improved as far as possible. Perfect communication is an illusory concept. The first major step in overcoming barriers to communication is to develop an awareness about the existence of some degree of distortion. The important approaches and methods that can be used to minimise distortion of information are as follows:

1. Orientation of employees.
2. Developing proper interpersonal relations.
3. Protective listening.
4. Using proper language.
5. Communication through actions and deeds.
6. Strategic use of the grapevine.
7. Feedback.

Orientation of Employees

When the subordinate is provided with information relating to company objectives, policies, procedures and authority relations, many possible conflicts and misunderstandings may be avoided. An employee who knows about the company's working environment is able to better appreciate problems of other people in the organisation.

Developing Proper Interpersonal Relations

Business or any other co-operative activity requires joint efforts for accomplishing its goals. The need is, therefore, to develop proper relations between different people working in the organisation. A senior executive should respect the dignity and authority of his subordinates and be kind and sympathetic to them. Subordinates should also trust their superior and keep him informed about their dealings with other departments and progress of their work. Status differences should be shelved; valid criticisms and suggestions should be appreciated. Superior and subordinate should develop a feeling of mutual trust and confidence. Wherever possible, the manager should communicate through personal contacts and emphasise that communication

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[1] Keith Devis, Humen Behaviour at Work (New Delhi, TMH EDITION, 1977 may be referred to for a detailed study, pp 394-404)

is a two-way process.

Protective Listening

Paying full attention to what is being said, allowing the speaker to state his viewpoint without premature evaluation or judgement are the pre-requisites of effective communication. Upward communication is often distorted when the manager uses his status and starts giving his own suggestions and viewpoints in the course of his face-to-face discussion with the subordinate without allowing him to fully express his feeling and emotions and state all that he has to say about a particular event. A manager should evaluate the information only when it has fully been communicated. Without empathetic listening, free and frank response cannot be expected. In protective listening, the listener tries to understand the viewpoint of the communicator without prejudging, approving or disapproving what he says.

Using Proper Language

Semantic distortions can be minimised by communicating the message in direct, simple and meaningful language. Use of technical terms should be minimised. Information should be worded so as to reach the level of the readership. Reason is very simple. Communication is not accepted if it is not properly understood. Where symbolic meanings are more potent than their real meanings, such words should be used with some explanation.

Communication through Action and Deeds

When a message is communicated without being acted upon, it tends to distort the current and subsequent communication from the manager. Reason is that action and deeds often speak louder and clearer than words. If acts of the senior differ from what he says, subordinates will gradually become used to 'listen' to what he does and not what he says.

Strategic Use of the Grapevine

Grapevine is an essential part of the communication network in every organisation. Though it suffers from a number of limitations, informal communication cannot be stamped out by the manager. There are occasions when due to personal and other reasons information should not be transmitted through the official channels of communication. Resignation of a top-ranking manager may, e.g., be communicated through the grapevine. Occasionally, grapevine may be used to effect prompt action. Thus, strategic use of the grapevine will go a long way in improving effectiveness of communication.

Feedback

Feedback is also very important in improving communication. Meaningful communication occurs when it is received as it was intended. A simple way to ensure that communication has resulted in mutual understanding is to observe behaviour of the subordinate and notice how far his actions conform to the requirements of the message. When message is communicated through face-to-face personal contact, the subordinates' facial expression may provide a useful feedback. Performance reports, question clarifications, suggestions, and empathetic listening are also very useful in providing the necessary feedback.

The Union Role in Communication

It is an admitted fact that in the organised industry employee union represents the employee group. As such, union is immensely interested in the information that employees receive from time to time. Of course, the degree to which a union should participate in any organisation's communication programme is debatable. But such participation has certain merits and demerits.

The obvious advantages of using the union are:

(i) Since employees largely depend on such union for a variety of matters, it can be considered as a regular channel already established.

(ii) Support of any information by the union is likely to strengthen employees acceptance of the same.

(iii) In case the information is passed to the employees without consulting the union, the possibility of interpreting such a situation by the union in its own manner cannot be ruled out. In such a case, interpretation of the union may be detrimental to the interest of the organisation.

However, the demerits of employing a union in communication need also be kept in view in this connection. The demerits may be stated as follows:

(i) Transferring some of the communication function to the union signifies release of control but management stands responsible as earlier which is not judicious.

(ii) The union may misuse the information for its own end.

(iii) The union has its own communication problem which is not effective in most of the organisations. Evidently, additional responsibility in this matter may not get that much of attention and priority as required. On the contrary, there is likely to be delay in communication.

It may be emphasised, however, that in almost all the organisations the union is already involved in such communication activities as grievance procedure, settlement of disputes, work study at the shop floor level, etc. Normally, the question is whether the communication programme for the union should further be broadened.

Undenyingly, this depends on the nature of co-operation and understanding which exists between the management and the union. But, however, management should always keep in view that any information released to the union should simultaneously be circulated to members of the management group to help supervisors and executives deal with employees and the union effectively.

SELF-TEST QUESTIONS

1. Define "direction". Explain the different approaches to direction.
2. Enumerate the different principles of direction.
3. Define "channels of communication". Discuss the main characteristics of formal and informal channels of communication.
4. Explain the principal barriers to communication and suggest measures for overcoming such barriers.
5. Write short notes on:
   (a) Communication media

(b) The role of union in communication

(c) Grapevine.

Suggested Readings:

(1) Human Behaviour at Work — *Keith Davis*

(2) The Process of Management — *Newman, Summer and Warren*

(3) Principles of Management — *Henry H. Albers*

(4) Management — *Harold Koontz, Cyril O. Donnel and Heinz Weihrich*

STUDY XVI

MOTIVATION, MORALE AND LEADERSHIP

MOTIVATION

Meaning and Nature

The word motivation is derived from the Latin term movere, which means to move. Today, of course, the term means a lot more than this. Gary Desslor defines motivation as a reflection of "a person's desire to fulfil certain needs". Joe Kelly opines that it "has to do with the forces that maintain and alter the direction, quality and intensity of behaviour". And M.R. Jones has defined it as being concerned with "how behaviour gets started, is energized, is sustained, is directed, is stopped, and what kind of subjective reaction is present in the organization while all of this is going on".

According to one approach to motivation, individuals have inner needs that drive them to behave in ways to fulfill these. Another approach views motivation as the function of outcomes that a person visualises as materialising consequent upon his action and the desirability of these outcomes in his perception. Yet another approach views motivation as the memorization of consequences of past action so that organisms learn to act in ways that are associated with/or result in favourable outcomes/rewards. Thus, it may be seen that the subject matter of motivation is full of jargons, familiarity with which is essential to its understanding. Following is a glossary of terms used in literature relating to motivation.

Motivational Terminology

A *need* is a requirement of a person for operational adjustment to the environment.

A *drive* is a physiological condition that moves the person to satisfy needs. It is not specifically directed to some object. The hunger drive, for enough, moves us to satisfy a need for food, but not towards a specific type of good.

A *motive* is our urge to attain some goal or objective, such as food when hungry. Motive is clearly goal directed.

An *incentive* is the object or end of the motivated behaviour such as a thing one wants to achieve, accomplish, or avoid.

A *reward* is similar to an incentive, but it implies that the incentive is positive. It refers to a satisfying outcome that flows from a behaviour, thereby inducing a person to adopt that behaviour again to receive the same outcome.

Wants are similar to needs but imply that the object is social, not merely physiological.

Goals are the objects that fulfill or satisfy the relevant want, need, or drive. Intermediate goals refer to the sub-goals set up for achievement on the path towards the final goal.

Intermediate goals may help to maintain morale and long-term effort towards more distant goals.

Aspiration refers to the plans and strivings involved in reaching a certain goal or

best of performance.

Thus, an aspiration to achieve the goal or object of the president of the company may be motivated by a want for prestige rather than by a drive to satisfy the need for shelter or even the secondary need for a bungalow type residence for shelter. On the way to achieve this goal, the various intermediate goals of a Manager, General Manager or Vice-President will be incentives of sufficient reward value to keep the person aspiring towards the goal.

The Need-want-satisfaction Chain

On the basis of above description, motivation may also be seen as a chain reaction, beginning with felt needs, resulting in wants or goals sought, which give rise to tensions (that is unfulfilled desires), then causing action towards achieving goals, and finally satisfying wants. This can be diagrammatically presented as follows:

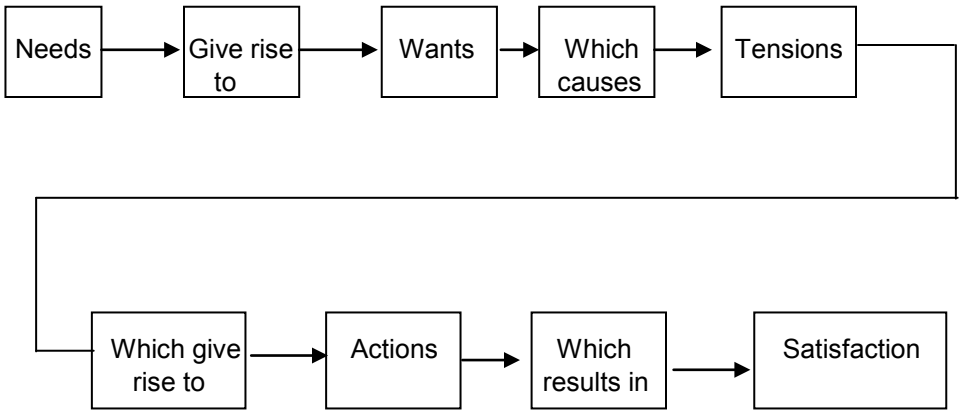

Figure 1

It should be kept in mind that this diagram depicts only a general model of the motivation process. In reality, motivation is a very complex process for the following reasons:

(i) The exact cause or motive a person has for a particular action cannot be seen; it can only be inferred. Thus when a salesman is explaining the benefits of his product to a customer, it does not necessarily mean he is motivated by customer's welfare. In fact, he may simply be trying to influence the customer to sell his product somehow.

(ii) Individuals to do have lots of needs and expectations which may be in conflict with each other and it may become difficult to say which need is impelling the person to act at a point of time.

(iii) People try to satisfy their needs in different ways. Therefore, it is not necessary what motivates 'X' individual will also motivate 'Y'.

(iv) Satisfaction of a particular need may actually lead to an increase in its intensity. It is, therefore, not a sure indicator of a person being really motivated. For example, a highly paid employee may still want more money to work more.

(v) Lastly, goal-directed behaviour does not always lead to need satisfaction. There are so many factors determining the inner satisfaction of a person.

Usefulness of Motivation in Management

Since management involves creation and maintenance of a healthy environment where the individuals can perform effectively and efficiently, it necessarily follows that a manager cannot get the best of work from his subordinates without knowing what motivates them. In fact, a deliberate attempt has to be made to build up a motivational system in the organization which will make the entire managerial process a success. As Koontz and O'Donnel put it "The primary task of managers is to get people to contribute activities which help to achieve the mission and goals of an enterprise or of any department or other organized unit within it. Clearly, to guide people's activities in desired directions requires knowing, to the best of any manager's ability, what leads people to do things, what motivates them". It is true that people join organisations to achieve certain goals as members of a cohesive group. But it is not necessary that they are always willing to work for attaining these goals. Chester Bernard recognised the willingness to work or co-operate as an important element in the success of an organization. And, of course, people's willingness is determined by many factors. It is the responsibility of management of any enterprise to "build into the entire system factors that will induce people to contribute as effectively and efficiently as possible. A manager does this by building into every possible aspect of the organizational climate those things which will cause people to act in desired ways".

Steps in Motivation

The steps of motivation which tell us what is to be done, are as under:

(1) *Size up situation requiring motivation:* All people don't react in exactly the same way to the same situation. The manager has to make sure of motivational needs of employees with a view to designing appropriate motivating tools.

(2) *Prepare set of motivating tools:* The manager should select and apply specific tools of motivation to satisfy motivational needs. This exercise is usually based on personal experiences.

(3) *Selecting and applying the appropriate motivator :* This involves selection of appropriate technique, method, timing and location of application of the technique.

(4) *Follow-up the result of the application:* Its objective is to ascertain whether an employee has been motivated or not and to evaluate motivation plans for further guidance.

Motivation and Behaviour

Behaviour is motivated by a desire to attain some goal. But an individual is not always aware of the goal he is pursuing. Sigmund Freud was among the first psychologists to emphasize the importance of unconscious motivation. According to him, people are not generally aware of each and everything they want. They will often have new needs, tastes, attitudes according to the circumstances and situations which strongly affect their behaviour, but at present they cannot make out all these. Motivation, he explained is like an iceberg. Only a small proportion of it could be seen above the surface in a form which an individual can recognise and be aware of, while the greater part were hidden and blocked off from consciousness by powerful forces. If many of an individual's needs are kept in an unconscious state, tension could accumulate and this may lead to mental diseases. He also described the impact of early experiences in the childhood on the personality of an adult. By the age of five, most of the future outlines are drawn, things might change in developing the personality, but fundamentals remain the same. Dr. Wilder Penfield, a neurosurgeon from McGill University discovered in 1951 that not only the past events are recorded in detail in the brain, but also the feelings that are associated with those events. An event and the feelings which are produced by the event are inextricably locked together in the brain. The memory record continues in fact even after the person's ability to recall it disappears. The brain functions as a high fidelity tape recorder. The recorded experiences and feelings associated with them are available for reply today in as vivid a form as when they happened and provide much of the data which determines the nature of today's transactions. Dr. Eric Berne developed this concept further and devised a scientific method to study human behaviour. He originated Transactional Analysis (T.A.).

Transactional Analysis

A transaction, according to Eric Berne, is the unit of social intercourse. When two or more people encounter each other, sooner or later one of them will speak or give some indication of acknowledging the presence of others. This is called the transactional stimulus. The other person will then say or do something which is in some way related to the stimulus, and that is called the transactional response. Transactional analysis is the method of examining the social intercourse of this type. It helps in finding out 'why people do as they do' by determining which part of the multiple natured individuals is being activated in any transaction. The parts of the multiple nature of an individual which are recorded in the brain and are replayed in course of a transaction are described as: parent, child and adult, (PAC) ego states.

PARENT
(TAUGHT CONCEPT OF LIFE)

ADULT
(THOUGHT CONCEPT OF LIFE)

CHILD
(FELT CONCEPT OF LIFE)

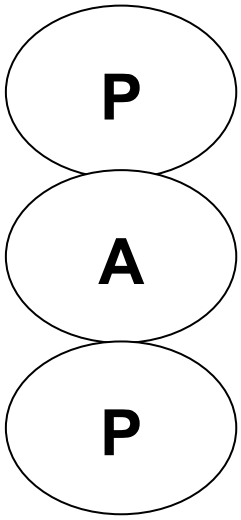

Figure 2

Parent: What a child sees his parent doing and what he hears from them are recorded straight in the mind in his early five years. Thus, hostility of parents is recorded with terror and the love with pleasure. Thousands of no's and repeated do not's are recorded in this set. It is thus taught concept of life. The recordings are available for replay throughout the life. These are reflected in such words as 'work hard', 'do not worry,' 'everything will be O.K.', 'done well', 'never do so again' and such actions as outstretched arms, hugging, foot tapping, blessing, rebuking, etc.

Child: This is the recording of the response of 'little person' to what he sees and hears. It is done simultaneously with the recordings of external and imposed events which we have described as parent. Most of the reactions of the child are 'feelings'. He is small, he is dependent, he is clumsy and so on. When a person is in the grip of feelings, we say that his child has taken over. It is thus the felt concept of life. It is reflected in such words as: 'do not leave me', 'I would not do so again', 'I wish', 'I want' and in such actions as tearful eyes, surprise on face, anger, pleasure, pleading for something, being playful, etc.

Adult: When the child is able to move at about 10 years, the recording of adult also starts. The self actualisation is the beginning of the adult. An important function of adult is to examine the data in parent whether or not it is true and to examine the child to see whether or not the feelings are appropriate to the present. It is thus the thought concept of life. During early years, adult is fragile and tentative. It cannot change or erase the recordings in parent and child.

Adult is reflected in such words as 'why', 'who' and such actions as 'listening', 'thinking', 'pondering' and 'reflecting', etc.

Any social intercourse may be parallel or crossed. The parent-parent, child-child

or adult-adult transactions are parallel. These are complementary and can go on indefinitely (except child-child transactions which are few as the child is a get stroke rather than give stroke creature). Parent-child, child-parent, parent-adult, adult-parent, etc., are the examples of crossed transactions.

Illustration

1. Stimulus : Support staff is indisciplined.
   Response : It is a sign of the times (Parent-parent).
2. Stimulus : You have presented a good report.
   Response : Thank you (Adult-adult).
3. Stimulus : I wish you were better educated.
   Response : I am not so lucky (Child-child).
4. Stimulus : I have to finish the report tonight as it is due tomorrow.
   Response : You always leave things to the last minutes (Adult-parent).
5. Stimulus : Your are always late.
   Response : Sorry Sir! (Parent-child).

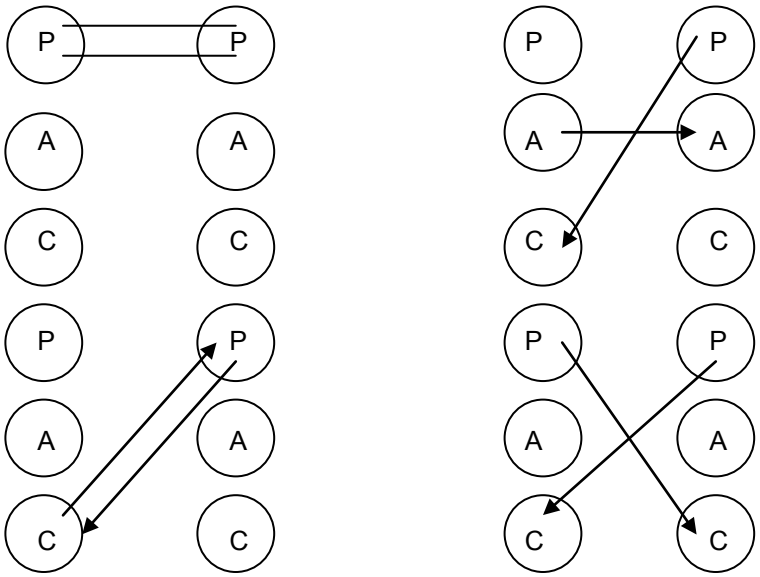

Figure 3: Parallel and Crossed Transactions

Life positions: Early experiences in life make oneself conclude about himself and the world at large one of the possible life positions.

1. I am not O.K. - You are O.K.
2. I am not O.K. - You are not O.K.
3. I am O.K. - You are not O.K.
4. I am O.K. - You are O.K.

Very early in life every child concludes: I am not O.K. - You are O.K. because of his imperative need to depend on others. By the end of second year in life or sometimes during third year, the child decides about one of the first three positions and once finalised he stays in that position and it governs everything he does. It stays with him the rest of his life. The decision is based on stroking and non-stroking. When

the mother is cold and non-stroking, the child may conclude: I am not O.K. — You are not O.K. Where the child is brutalised long enough by the parents, he may switch over to the position: I am O.K. — You are not O.K. which is a criminal position. The child decides, you have hurt me, you are not O.K., I am O.K. He sees toughness and becomes tough.

The fourth position I am O.K. — You are O.K. is a conscious and verbal decision. The first three positions are based on feelings. The fourth is based on thought, faith and ways of action. The first three have to do with why. The fourth has to do with why not? The person does not shift to a new position. It is only a decision he makes. The 'not O.K.' feeling cannot be erased by it. It is like conversion experience. This is the position which can lead to better communication and understanding of human behaviour and motivation.

The goal of transactional analysis is to enable a person to change will, to change the responses to recurring and new stimuli. He helps in regaining the freedom of choice which is lost by most of the people in early childhood by building a strong Adult.

The strength of Adult is increased in the following way:

1. Learn to know one's own child, to be sensitive to one's not O.K. feeling.
2. Recognise your parent: its admonitions, injunctions, fixed positions. One way to practice identifying the parent and child is to monitor the internal dialogue. When one is able to say, 'that is my parent', or 'that is my child', one says it with the adult. Thus by the very process of questioning one has shifted to the adult.
3. Be sensitive to the child in others. It may be helpful in a difficult transaction to see the little boy or little girl in another person and talk to that little boy or girl, not in condescending way but in loving, protective way.
4. Take time to make big decisions about basic values which will make a lot of smaller decisions unnecessary. These decisions form an ethical basis for the moment to moment questions of what to do. It requires conscious effort to make such decisions.
5. Give time to adult to process data, sort out parent and child in reality.
6. When in doubt, leave it out. One cannot be attached for what he did not say.

Transactional analysis offers an excellent model for improving organisational health. The traditional parent-child relationship between the managers and subordinates may be gradually changed to adult relationship. New organisational scrips may be formed and practised. Unique talent of each person will be appreciated and utilised. It would be like saying, 'I am manager of the department, so are you for the job assigned to you. You do not need a corporate parent to tell you what to do and when to do. You can take decisions which concern you. Management has full faith in you'. When people within an organisation increase the number of I am O.K. — You are O.K. transactions, decentralisation of authority is facilitated, confidence in individual is built and he is motivated to contribute his optimal effort for the accomplishment of the objective.

Manager can also enrich jobs increasing the number and quality of positive strokes people get from their work. For example, the manager decides that the usual practice of getting each correspondence okayed by him before it could be sent out will not be insisted upon. The concerned officers would sign their own letters and be responsible therefor. In terms of TA this will mean giving employee Adult responsibility rather than forcing him to seek Parental approval for the correspondence. The employees will be encouraged to interject their own personalities into their letters. They will feel motivated to do better in a situation where some controls are removed, job freedom and additional authority are granted even though accountability and responsibility are increased.

A manager with strong adult will help move his subordinate away from child ego state to adult. The subordinate child's ego state is the most vulnerable part of his or her personality. It contains all the 'not O.K.' feelings that the subordinate has. If the manager's critical parent assumes control of the situation, the child in the subordinate may rebel, in silence, through absenteeism, and lower productivity. On the other hand, if Adult assumes control, it would encourage subordinates to solve the problems in a rational and Adult manner. The Manager with Adult in control can brave the angry outburst sharp tongue, resist the flatterer and the yesmen and face the child ego state in himself and encourage subordinate to more rewarding behaviour leading towards I am O.K. - You are O.K. transaction.

Benefits of TA:

TA can give employees fresh insights into their own personalities and it can also help them understand why other sometimes respond as they do. A major benefit is improved inter-personal communication. Employees can sense when crossed communication occurs and they can take steps to restore complementary communication. TA is especially useful in sales and other areas where success depends on customer relations.

Selected Theories of Motivation

How can one truly understand the motivation process? Over the last three decades a number of important theories have emerged, each in its own way trying to explain what motivation is all about. Some of these theories are explained hereunder.

(a) *Monistic or Economic Theory of Motivation:* Monistic theory of motivation is based upon the notion that man is essentially economic. Individuals are assumed to be highly responsive to money reward. People feel highly motivated when rewarded with more money. This theory seeks a single cause of behaviour - monetary aspect of remuneration or reward. People repeat their behaviour if it leads to reward. The theory postulates that:

(i) motivation is more effective and direct when based upon individual incentives rather than group incentives;

(ii) the incentive is more effective where reward immediately follows the efforts. Thus, efficiency bonus paid at the end of the week is found more stimulating than paid at the end of the year; and

(iii) quantum of effort is directly related to the amount of reward. Thus, marginal increase in reward for added output does motivative people to the same extent as the substantial increase in reward does.

Taylor's differential piece rates form a strong overtone of economic motivation. Though people are stimulated by motives other than those economic in nature monistic theory is not completely wrong. Financial rewards do have significance, if not maximum, motivational effect. However, it would not be judicious to assert that financial incentives are the only source of motivation. Perhaps better or at least the same result can be achieved by giving considerations to the incentive other than those economic in nature. Thus army personnel or people in religious organisations are highly motivated by factors other than those contemplated by monistic theory. Moreover, financial incentives generally inflict too much pressure and tension on the worker.

To quote Barnard (Functions of the Executive), ".....material rewards are ineffective beyond the subsistence level excepting to a very limited proportion of men; that most men neither work harder for material things, nor can be induced thereby to devote more than a fraction of their possible contribution to organised effort. The opportunities for distinction, prestige, personal powers, and the attainment of dominating position are much more important than material rewards in the development of all sorts of organisations, including commercial organisations".

(b) *The Hierarchy of Needs Theory:* An understanding of human needs and the role played by them in directing and shaping people's behaviour is absolutely essential for securing the desired motivation. Maslow[1], a psychologist, developed a theory of motivation based on human needs arranged in a particular order from the lower to the higher. The hierarchy of needs of motive suggested by Maslow may be shown in the following diagram and analysed in the following manner.

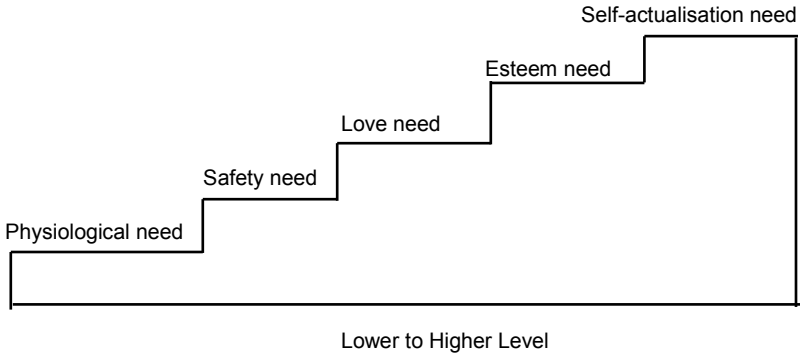

Figure 4

[1] A.H. Maslow, Motivation and Personality.

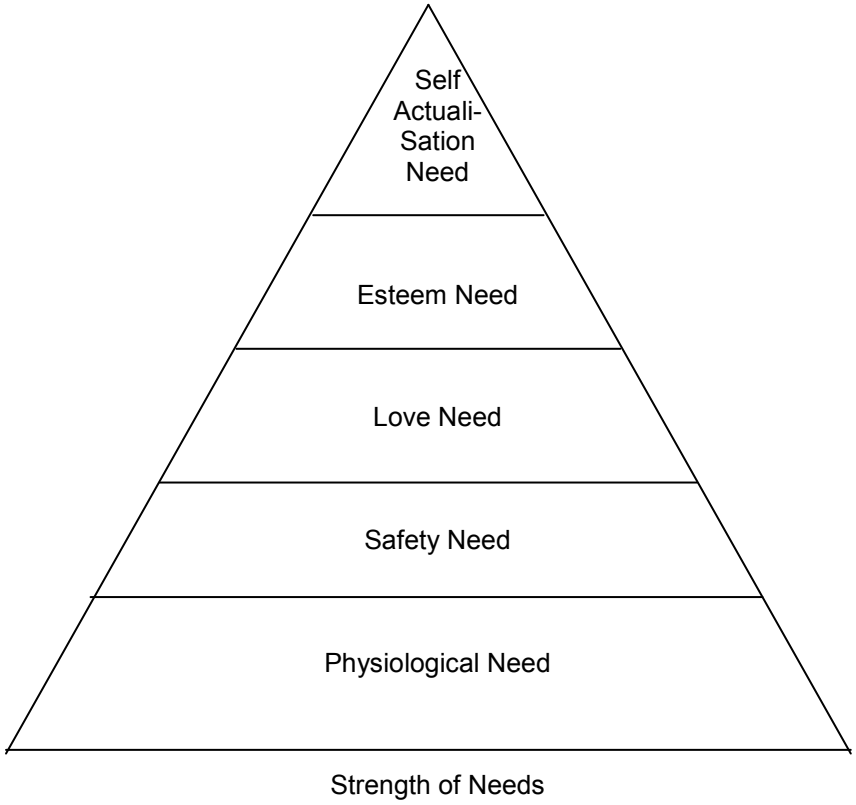

Figure 5

1. *Physiological Needs:* These are needs for food, thirst, shelter, and the like. Physiological needs are the basic needs of the organism and are essential for survival. Physiological needs lie at the lowest level of the hierarchy of needs. However, when thwarted, those needs become the most pre-eminent in importance. For a man whose basic needs are not satisfied, other higher needs for love, status, or self-fulfillment are generally inoperative or less significant. But once-satisfied, the basic needs cease to be important in motivating individuals. This is the reason why in underdeveloped countries physiological needs are still powerful motivators. But in more developed countries such needs hardly stimulate people to desired action since these are well satisfied. This happens because a satisfied need no longer motivates the individuals till there is some change in him or his environment that renews the strength of the need.

In organised co-operation physiological needs are satisfied through adequate compensation (i.e., pay) and through job security. Pay includes salary, efficiency bonus, and fringe benefits. Motivating employees through pay signifies that level of remuneration is such as will attract and hold employees of proper skill, ability, and experience. Job continuity or security satisfies physiological needs of subordinates for a long time to come. But job security does not mean guaranteeing employment for all the time to come irrespective of his conduct and performance on the job. Motivating people through jobs security implies that subordinate will not be rendered

unemployed on flimsy grounds and unjustified complaints of others. So long as his performance is satisfactory and he abides by all rules and regulations of the enterprise in force from time to time, management must assure employee that his employment will be maintained.

2. *Safety Needs:* Safety needs represent the second level in Maslow's need hierarchy. These relate to protection against danger, threat and deprivation. Safety needs are more important when a man is in a dependent relationships and fears arbitrary deprivation. Since people in the organisation stand in dependent relationship, safety needs become important in informal structure. An attempt by top management to undermine or weaken the trade union or the social groups to which an individual is attached may be viewed as threatening his safety. In the same way, arbitrary management actions arousing uncertainty as to job continuity also influence people's actions and job satisfaction. Security however, casts a negative influence and is, therefore, short-lived.

Safety needs are very closely related to physiological needs; both the needs seek continuation. Like physiological needs, safety are also powerful motivators to a certain level of satisfaction and beyond that these become insignificant. If a subordinate provided with too much of security it may even cause loss of initiative and creativity on his part. People therefore, need to be provided with security up to a limit.

3. *Social Needs:* Next in order are the social needs. when physiological and safety needs are fairly satisfied, safety needs become powerful motivators. These needs are what Maslow calls "the love and affection and belongingness need".

As a social element it is the desire of human being to be accepted by others. Need for belonging is manifested in the form of social groups on informal basis. Groups, cliques and subcliques as part of the informal organisation exist in every enterprise along with its formal structure. Normally, groups consist of congenial co-workers with whom a member can exchange ideas and views, and talk in confidence. Since a single social group does not satisfy enough of a man's social needs, he normally belongs to more than one group.

A cohesive group under proper conditions can be more effective than an equal number of separate individuals. However, there are managers who view social groups as hostile to organisational objectives and resort to actions inimical to the natural tendency of human beings to belong to each others and form groups. People, in turn, tend to rebound to such unscrupulous acts of management by becoming resistant, antagonistic and unco-operative. Management in its own interest and in the interest of organisation should, therefore, encourage constructive and productive groups and wherever possible, change, job assignments to help maintain such groups intact. Destructive groups, on the other hand, should either be eliminated or rendered harmless. One way to make them inoperative is to scatter its active members by frequently transferring them to different jobs. However, attempts should also be made to turn hostile groups into constructive ones through understanding and use of dynamic leadership qualities. Wherever possible, management should provide opportunities for group interaction both within and outsides the enterprise.

4. *Ego Needs*: Once physiological, safety and social needs are well satisfied, ego needs become more important to management and to the individual himself. Ego

needs are of two kinds:

(i) Needs relating to one's self-esteem such as self-respect, self-confidence and achievement.

(ii) Needs relating to one's reputation such as status, recognition, prestige and attention.

Ego needs become powerful motivators only when all the three lower order needs are reasonably satisfied. However, unlike physiological, safety and social needs, ego needs can rarely be satisfied so well, and people seek more satisfaction of these needs. Another problem with ego needs is that since these relate to very personal motives of individual, organisations can afford somewhat limited avenues for their satisfaction.

Ego needs relating to reputation as outlined above may be satisfied through promotions and allotment of status symbols to deserving individuals in the organisation. Use of status symbols is very common in military organisations. Ego needs relating to self-esteem may be satisfied by assigning challenges and stimulating work the accomplishment of which will result in recognition. A feeling should be inculcated in the subordinate that he is doing a useful job and the job is important to the organisation. Moreover, intimating people the significance of their efforts to the accomplishment of organisational goals will also satisfy some of their ego needs.

5. *Self-Actualisation Needs:* At the apex or Maslow's hierarchy are the need to self-actualisation, or what are viewed as the needs for fulfillment. These are needs relating to personal growth and realisation of man's full potential. The need for self-actualisation is not strong in all subordinates. At the same time, organisations generally offer limited opportunities for satisfying self-actualisation needs.

Being close to the scene of action a subordinate may possess valuable information which he may wish to pass on to superior for improving latter's quality or decisions. Providing employees the opportunity to participate in management can be a significant method of satisfying in part their need for self-actualisation. Management should also encourage and reward creativity and thus enable the subordinate to grow and realise his full potential. As compared to money compensation, personal rewards are more powerful and better stimuli at the higher levels of organisation. Allowing the subordinate sufficient freedom to work in his own way within the limits of authority delegated to him and creating an atmosphere conducive to individual growth and development will also be helpful in satisfying his need for self-actualisation.

Management should bear in mind that in all circumstances satisfied need ceases to be a powerful motivator of human behaviour. Moreover, needs at different levels of its hierarchy are interdependent and overlapping. It is not that needs at a given level must be fully satisfied before proceeding to the needs of next higher level. The fact is that most people are partially satisfied and partially unsatisfied in each need area. Maslow had demonstrated this by picturising the average citizen as 85 per cent satisfied in his physiological needs, 70 per cent in his safety needs, 50 per cent in his belonging needs, 40 per cent in his egoistic needs, and 10 per cent in his need for

self-fulfillment.

Maslow's need hierarchy theory of motivation has been criticised on the ground that it leaves no room for difference between individuals. For one individual, self-actualisation might be the dominant motive guiding a large part of his behaviour, and for another individual working under essentially the same circumstances, it may not be so. That is, two individual whose needs for say, food, safety and belonging are fairly well satisfied may not necessarily be motivated to the same extent by egoistic or self-actualisation needs. In one study[2] conducted to determine whether an increase in the satisfaction of the type of needs serves to strengthen motives at a higher level, it was found that no evidence in support of the theory existed. Thus, Maslow's need hierarchy is yet to gain much of the research support.

(c) The Theory of Douglas McGregor: The late Douglas McGregor has applied the fundamental content of the theory of Maslow to leadership and management theory. There are certain conventional assumptions relating to motivation of people in the organisations that are widely accepted as valid even though these provide only a part of the answer. These assumptions are termed by McGregor as "Theory X". The important assumptions underlying this theory are as follows:

(i) The average man by nature is indolent and has an inherent dislike for work; he will not work if possible.

(ii) Dislike for work implies that people require to be directed and controlled through active intervention by management.

(iii) It also implies that they must be persuaded, rewarded, punished and threatened with sanctions so that they put in sufficient efforts for accomplishing organisational objectives.

(iv) Man is inherently resistant to change and passive to organisational needs.

(v) He lacks ambition, avoids responsibility and prefers to be led.

The above assumptions guide management behaviour and thinking. There are managers who follow the "hard" approach involving coercion and threat (usually disguised), and close supervision and control in dealing with their subordinates. Management can even be "soft" attempting to direct by being permissive, i.e., relationship-oriented and satisfying people's immediate needs. Hard approach often leads to consequences like restriction of output, militant unionism, antagonism and attempts to thwart management objectives. Soft approach, on the other hand, may lead to indifferent performance and abdication of management in favour of harmony. People may, at time, develop the habit of expecting more and giving less.

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[2] D.T. Hall K.E. Naougain "En Examination of Maslow's Need Hierarchy in an organisation". Organisational Behaviour and Human Performance, Vol. 3 (1968), Quoted by John B. Miner in Management Process – Theory, Research and Practice.

Sociologists agree that human behaviour in individual organisations tends to approximate management's expectations under conventional approach of Theory X. But what they do not agree to is that such a behaviour is the consequence of man's inherent nature rather it is contended that such behaviour is the outcome of "individual organisation and management philosophy, policy and practice". Thus, cause is mistaken for effect.

A fundamental opposition of Theory X is that it is inadequate to consider the subject of motivation. It is to acknowledge that satisfied need ceases to motivate any individual further. Since there exists hierarchy of needs, man moves from satisfaction of lower needs to the satisfaction of higher needs. Once physiological and safety needs are satisfied, social needs, ego needs and need for self-actualisation respectively become the most important motivators. Management by direction and control (Theory X), regardless of its hard or soft approach, is ineffective to motivate people whose important needs are social and egoistic. Once lower order needs are satisfied, rewards, promises, incentives, or threats and coercion the devices used by management under Theory X, cease to motivate people.

Having established the inadequacy of Theory X, McGregor suggested a different theory of managing people based on more adequate assumptions about human nature and motivation. He labelled that attitudinal pattern of managers as "Theory Y". The important assumptions of Theory Y, described by McGregor are:

(i) Man is not inherently passive or resistant to organisational needs.

(ii) Incentive, threat, or external control are not the only means of motivating people to work for organisational objects.

(iii) "The motivation, the potential for development, the capacity for assuming responsibility, the readiness to direct behaviour towards organisational objectives are all present in people. Management does not put them there. It is the responsibility of management to make it possible for people to recognise and develop these human characteristics for themselves".

(iv) Under proper organisational conditions and methods of operation man will exercise self-control towards achieving his own goals and those of the organisation.

The fundamental implication of Theory Y is that full advantage of the personal and professional potential of employees can be taken by motivating them to accept organisational objectives, more particularly when their physiological and safety needs are well satisfied. Besides, it is also true that Theory Y makes use of the motivational techniques that are precluded by Theory X-the socio-psychological restraints imposed by it. However, after generations of adherence to the conventional organisational theory, shifting to Theory Y is by no means any easy task.

In view of the above Theory 'Y' is preferable. However, it has to be applied gradually. The basic problem in most of organisations is that of securing commitment of workers to accomplish organisational goals. Workers' commitment is directly related to the satisfaction of their needs. Theory 'Y' places emphasis on the satisfaction of the needs of the workers and it does not rely heavily on the use of authority as an instrument of command and control. It assumes that workers exercise self-direction and self control in the realisation of the goals to which they feel themselves committed. Because of these reasons, Theory 'Y' is realistic and frequently used at different levels in most of the organisations.

Douglas McGregor had also stated that Theory-X and Theory-Y are underlying beliefs about the nature of man that influences managers to adopt one strategy then the other. He admitted the possibility that a manager might employ parts of both Theory 'X' and Theory 'Y' and a manager might shift from one to the other depending upon the situation and the persons involved.

(d) Herberg's Motivation-Hygiene Theory: This is also known as the two factor theory and was developed by Frederick Herzberg. He conducted a large number of interviews with a view to determining the attitude of people towards their job. Those interviewed were asked to describe when they felt good about their job and when they had bad feelings about their job. It was observed from the study that good feelings were generally related to intrinsic or job content factors, such as achievements, recognition of achievement, the work itself, advancement, giving of responsibility, and the potential for growth. Since these factors contribute to good feelings and simulate people for better performance these are also described as the motivators.

It was also found that bad feelings about the job were for most part related to context factors, such as company policy, administration and supervision, interpersonal relations with peers, interpersonal relations with subordinates, working conditions, pay increases, the status situation, and job security. Context factors are also known as extrinsic or hygienic factors.

The two-factor theory reinforces the belief that motivators are the source of job satisfaction as well as effective role behaviour. Since hygiene factors are fond related to job dissatisfaction, management should not attempt to motivate people through these factors. Intrinsic factors, on the other hand, are positively related to job satisfaction and thus deserve close management attention. Management should, therefore, attempt to make the job more meaningful and satisfying.

In several respects the two-factor theory is closely related to the need hierarchy approach to motivation. The extrinsic factors are like the Maslow's low-level physiological and safety needs, and must be dealt first if dissatisfaction is not to cause difficulties. The content factors of motivation hygiene theory of Herzberg roughly approximate the higher level needs under Maslow's need hierarchy system.

Comparison of Maslow's and Herzberg's Theories of Motivation

MASLOW'S NEED HIERARCHY	*HERZBERG'S TWO-FACTOR THEORY*	
Self-actualisation	Challenging work Achievement Growth in the job Responsibility	Motivators
Esteem or status	Advancement Recognition	
Affiliation or acceptance	Status Interpersonal relations Company policy and administration Quality of supervision	Maintenance Factor
Security or Safety	Quality of supervision Working conditions Job security	
Physiological needs	Salary Personal life	

Herzberg's theory assumes that intrinsic and extrinsic factors produce altogether different motivational effects - positive and negative. The said proposition is generally supported when the critical incident method as used by Herzberg in developing the theory is employed to test it. However, other research approaches fail to confirm the theory[3]. A given factor may be a source of satisfaction for one person and dissatisfaction for another. Thus, individual variations underlying motivational aspect of human behaviour are not taken due cognizance of by this theory.

(e) Expectancy Theories of Motivation: The expectancy theories are based on the expert-contributions of psychologists such as Victor H. Vroom, Lyman W. Porter and Edward E. Lawler. Although these authors use highly specialised terms in their motivation models, the basic factors included in their theories can be diagrammatically put as under:

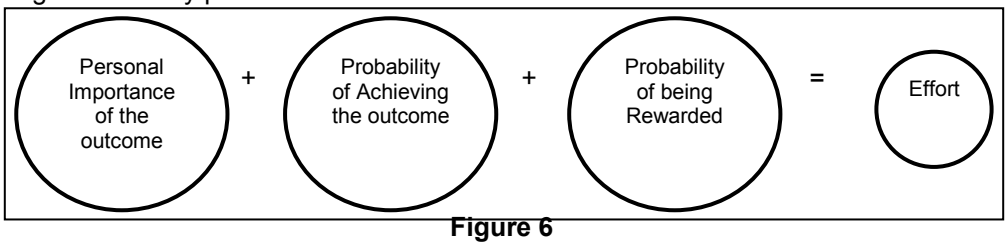

Figure 6

Thus, according to expectancy theorist, effort or motivation is primarily a function

[3] R.J. House & L.A. Vigdor, "Herzbergs Dual-Factor Theory of Job Satisfaction and Motivation: A Review of the Evidence and A Criticism", in Personal Psychology, Vol. 20 (1967), quoted by John B. Miner in The Management Process – Theory, Research and Practice.

of three factors: the importance to the person of particular outcome or opportunity, the probability (expectation) he or she has of achieving that outcome and the probability (expectation) the person has of being rewarded if the outcome, is successfully attained. Unlike the need hierarchy theory, the expectancy theorists opine that there are not predetermined patterns of needs and a person's motivation is determined by forward-looking beliefs about what will happen. Moreover, it is not the magnitude of any reward that is important, but the degree to which the individual expects to be rewarded. For example, President and Prime Minister of India are rewarding positions, but most of us do not run for them because we do not expect to be successful. Therefore, the managers consider the expectation model of the employees while trying to reward them effectively.

(f) McClelland's Needs Theory of Motivation: David McClelland of Harvard University and his co-workers have looked at certain peculiar motivating needs of the people in many cultures and many sections of the society. On the basis of their research, they have grouped the responses into three categories each representing an identifiable human motive or need. These are need for power (n/PWR), need for affiliation (n/AFF), and need for achievement (n/ACH). Most people have some concern for each of these needs in their thoughts, but seldom, in the same strength.

(i) The need for power: According to McClelland's tests, most managers have high need for power which, in turn leads to constructive authoritarianism. The need, combined with need for achievement or urge for excellence, can lead to productive and satisfying results.

(ii) The need for affiliation: People with a high need for affiliation usually derive pleasure from being loved and tend to avoid the pain of being rejected by a social group. These sort of people are often seen as ineffective go-getters probably because they are not task-oriented enough. This need is present in most managers, but is seldom dominant in successful individuals.

(iii) The need for achievement: People with a high need for achievement like personal responsibility, moderate and calculated risks, feedback on how they are doing. Unless moderated by other needs, a high-achiever tends to become individualistic to surpass others and succeed in any organisation.

However, the above mentioned needs viz., n/PWR, n/AFF and n/ACH do not strongly motivate most of the people. It has been found that as many as 90 per cent of people working in an organisation are not governed by these needs. Therefore, to motivative the majority, some other needs have to be identified and satisfied.

(g) Equity Theory of Motivation: Equity theory postulates that people are not concerned merely with the reward they get for their contributions; rather they compare their efforts and rewards with those of others. Thus, where an individual finds that he is getting less reward in relation to other people in the organisation for the same contribution and outcome he would surely be tempted to resort to negative behaviour so that balance is maintained.

An individual relates his own input/output ratio to that of some other person or persons with whom he compares himself. Inputs represent investment or contributions of an individual to the job. These may be perceived in terms of time or efforts spent, responsibility assumed, education or skill involved in doing the job. If the comparison points out to an imbalance or inequity, tension is produced. And this tension in turn provides the basis for motivation. Thus, an overpaid worker when remunerated on time basis is likely to restore the balance by increasing quality of work done by him.

Though, it can be applied to a variety of input-output relationships, equity theory is generally interpreted in relations to role behaviour as related to money reward or compensation. There arise situations when outcome in terms of factors like status, recognition, advancement, working conditions, or security are more important than the traditional outcome of compensation.

The most important drawback of this theory is that it does not specify the underlying motivational process involved or the particular method used in reducing tension and restoring balance. It only points out that inequity in input-output ratios of different individuals will generate tension and stimulate them to resort to certain role behaviour that are expected to reduce the inequity. How it is to be done and what methods should be used reduce the tension are the important problems. But they are not answered by the equity theory specifically.

(h) Contingency Model of Motivation: Attempts have been made by researchers in the recent past to integrate different variables suggested by earlier researchers so as to formulate a composite contingency approach. It is called contingency model, because motivation is contingent on a number of factors that are both internal and external to the individual. In essence, five factors are found to be most significant in determining personal effort and motivation:

(i) The opportunities available in, and the constraints put by, the environments as the individual perceives them.

(ii) The need structure and the relative strength of each need of the individual.

(iii) The rewards perceived to be associated with any goal or outcome.

(iv) The personal expectations of being successful in achieving the goal.

(v) The expectations of being rewarded if the goal is attained.

The significant conclusion is that motivation is determined by a combination of forces in the person and in the environment.

(i) Sound Motivation System: People are stimulated to work by factors external to the enterprise. However, in order to induce people to work as they are able and trained to do, management must provide them with additional inducements. Since there cannot be a single source of motivation, management should devise a system of motivation, within the framework permitted by the enterprise. The following guidelines are useful in developing such a system:

(1) A system of motivation should be so designed that it fully integrates with human needs and is consistent with people's motives. A motivational system not providing for satisfaction of human needs will not produce the desired results. While attempting to satisfy needs management should pay more

attention to the unsatisfied needs, because satisfied needs fail to stimulate people any further. Attempt should also be made to identify and recognise individual variations underlying human behaviour.

(2) Since stimulus cannot be a substitute for poor selection of employees a system of motivation should be based upon proper selection and orientation of people in the organisation.

(3) It should also be productive and motivate people to work more efficiently and according to best of their abilities and skill.

(4) A system of motivation should be flexible in the sense that it should be changed in the light of changes in environment and new knowledge gained in course of time.

Motivation has its roots in motives within the individual that stimulate him to action and particular pattern of behaviour. A lack of knowledge about human motives will result in failure to motivate. Further complications in motivating subordinates are introduced by the hidden motives of which people are not always consciously aware and as such, cause is often mistaken for effect, or vice versa. However, problems in motivations should not deter management from designing better motivational techniques, nor should its current popularity lead the executive to believe that motivation is management.

MORALE

Nature of Morale

Morale is a term that has been defined in a number of ways. Though real, morale is an intangible factor and relates to the conditions of an individual or group with regard to its determination, confidence, and enthusiasm in the performance of duty. It is sometimes defined as moral condition of an individual as regards discipline and confidence in relation to his job. For some people it includes the mental and emotional feeling of an individual regarding the task expected of him; for still others, morale may mean personal acceptance of group-goals. In relation to job, morale may be defined as the extent to which an individual perceives satisfaction of his needs as stemming from his total job situation. Morale should be viewed as a dynamic phenomenon relevant to al levels and category of employees and should be understood as the sum of psychic qualities reflecting courage, zeal and confidence in the performance of duty.

Morale and Productivity

Morale is frequently assumed to be associated with higher performance, greater satisfaction and increased productivity. However, research is yet to corroborate this. High morale may well be associated with low productivity. When an employee feels secure and is able to satisfy his personal motives independent of the attainment of organisational objectives, he may not attach any significant importance to his job efforts, though his morale may be quite high. In the same way, low morale and high productivity may coexist. Feeling of insecurity of threat of withholding or diminution of satisfaction may sustain better performance and higher productivity, though under

this situation morale is likely to be very low. Thus productivity may only be peripherally related to morale.

It is, however, worth noting that negative correlation between morale and productivity is based upon the notion of morale being equal to job satisfaction. Morale in the sense of confidence and enthusiasm for the job performance does influence productivity though the two need not always be positively correlated. Rensis Likert[4] also feels that most of the studies relating to morale and productivity have not confirmed any co-variation of two phenomenon because studies tend to focus on short-term costs. Moreover, research has not yet proved either that there exists no positive relationship whatsoever between morale and productivity, or that the management can afford to overlook the problem of employee morale without producing any adverse effects.

Factors Determining Morale

The following factors are generally found associated with morale:

1. Social Factors.
2. Supervisory Techniques.
3. Job Satisfaction.
4. Organisation and its purpose.

1. Social Factors: People derive satisfaction from their social relationships and compatibility with fellow employees. Informal groups gain more support particularly in the context of jobs that offer little or no intrinsic satisfaction. Cohesive groups provide support and consolation to their members and protect them by countering sources of threat. Thus cohesive groups greatly influence morale of their members. Management should, therefore, encourage and protect constructive informal groups and attempt to secure proper integration of group goals with those of the formal organisation structure.

2. Supervisory Techniques: Choice of techniques and adequacy of supervision at a given level have a direct bearing upon the morale of subordinates. Task oriented manager who adopts punitive or close style of supervision and direction is likely to undermine morale of his subordinates. On the other hand, manager with qualities like friendship, mutual trust, participation, respect, and supportiveness in his style of supervision and leadership is likely to boost up the morale of his subordinates.

3. Job Satisfaction: In the two-factor theory of motivation discussed earlier it was mentioned that certain intrinsic or job content factors like achievement, recognition, the job itself, responsibility, advancement, and potential for growth, etc., contribute to employee satisfaction. On the other hand, extrinsic or hygienic factors like company policy, supervision and administration, relationship with peers and with subordinates, status, personal life and security, cause dissatisfaction. The satisfiers or motivators are intrinsic to the job and evidently management should spend more time and money on these factors than on hygienic factors. The job itself is thus a source of satisfaction and any improvement in this direction is likely to favourably affect

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[4] Rensis Likert, The Human Organisation: its Management and Value.

people's morale.

4. Organisation and its purpose: An individual who upholds integrity of the organisation and perceives its purpose to the accomplishment of which his efforts are directed as worthwhile is likely to possess a high morale. Image of the enterprise in an individual's mind and pride in its objectives are, therefore, closely related to the phenomenon of morale.

Company policies, procedure and communication - all are important factors having a bearing upon morale of its employees. Similarly, type of the subordinate, his ability to get along with people and grasp problems are also related to morale. There are also such external factors like family relations and association with friends that influence a man's morale on the job. Thus, not a single factor but a combination of factors influence morale.

Morale is highly elusive and baffling phenomenon. Factors that are sometimes considered as contributing to high morale tend to destroy it sooner or later. Thus, soft management approach, if carried too far, may ultimately effect it in an adverse manner. A manager attempting to raise morale of his subordinates should, therefore, bear in mind its variability both with regard to its context and its content.

Knowing the Prevailing Morale

Employees morale may be ascertained on the basis of observation or attitude surveys. Thus, a manager may observe the activities, trends, changes in personal characteristics and behaviour of his subordinates to determine the level of their morale. Changes in willingness to co-operate should be more particularly observed. Success of this method will depend upon the ability of a manager to observe the things objectively.

Employee morale may be ascertained by conducting attitude surveys through personal interviews or use of printed questionnaire. Members are asked to supply information relating to their feeling about working conditions, supervisors, enterprise and its objectives, and the like. To be most effective, surveys should be repeated at intervals to determine the trend and ascertain the extent obstacles to morale previously reported have been removed. It is better if employees are informed at the earliest about the result of the survey and possible contemplated by management for countering unfavourable results.

Sometimes factors like rate of absenteeism, labour turnover, and grievances reported are also taken as indicators of morale. But this method cannot be considered sound because labour turnover, etc., are often influenced and caused by a number of factors not directly related to morale in any significant way.

LEADERSHIP

Meaning and Nature

Leadership is one of the important aspects of managing. It is an interpersonal process of influencing the behaviour of individual and the group so that defined objectives are accomplished willingly and enthusiastically. A leader directs and motivates members of the group. He also represent the group to the outside world and the outside world to the group.

Basically, a leader is the individual with the major influence in a group, whose role is to get others to achieve organisational goals. But 'leadership', like many other key concepts in management, tends to be viewed differently; depending on whether the orientation is behavioural, economic, or managerial. Ordway Tead has defined leadership as "the activity of influencing people to co-operate towards some goal which they come to find desirable". According to George R. Terry, "leadership is the activity of influencing people to strive willingly for group objectives". Robert Tannenbaum defines the leadership as "interpersonal influence exercised in a situation and directed, through the communication process, toward the attainment of a specialised goal or goals". Koontz and O'Donnell state that "leadership is influencing people to follow in the achievement of a specialised goal". A review of these and other writers reveals that most management writers agree that leadership is the process of providing direction in group activities and influencing others to achieve group objectives in a given situation. From this definition of leadership, it follows that the leadership process is a function of the leader, the follower, and other situational variables i.e. L = f(l, f, s). Although influencing others for attaining group goals 'is the essential function of a leader, some of the important element in the process of leading are:

(i) One who leads is a part of the group, and yet he must maintain his separate identity if he is to continue to lead.

(ii) Leadership contemplates interpersonal influence and close man-to-man relationship. It is rooted in feelings and attitudes that have grown out of reactions of individual personalities to each other.

(iii) It is a dynamic and ever-evolving process; a manager must lead continuously.

(iv) It involves directing, guiding and influencing the behaviour of individuals and groups so that future actions and behaviour are modified in the right direction.

Leadership and Management

Management functions include planning, organising, staffing, directing and controlling. In order to direct his subordinates a manager must motivate, communicate, supervise, guide and lead them. Thus, it is in his directing function that a manager becomes responsible for effectively and successfully leading his subordinates. Managing can be more effective if those who manage are also the leaders, because leadership can substantially influence the result. Since part of a manager's job involves getting things done through the efforts of other people he will be more successful in the job if he is also skillful leader. Following are the important favourable results produced if managers are also good leaders:

(i) The leader guides and directs by eliminating uncertainties as to what should be done, and thus co-ordinating individual efforts as to make them pull in one direction.

(ii) He motivates people and integrates individual needs with the needs of the organisation.

(iii) He represents group to the outside world and the outside world to the group. Leader is looked upon by the group as a source of information and satisfaction.

The three things provided by the leader as mentioned above are also referred to as direction, drive and representation, and are sufficient to prove that leadership is an essential part of successful management, It is, however, argued that since managers have authority to provide incentives, reprimand, fine, deprive, or otherwise punish aspired in the organisation, management leadership is not something to be so much aspired and that danger to leadership is more potential than real. Discipline and conformity can be maintained through the hierarchy and fear of loss of employment. The argument is consistent with Theory X. But the fact is that for optimum results consistent with man's integrity people need to be voluntarily led.

However, leadership should not be emphasised so as to make it synonymous with management. It will improve the results if the manager is also a skillful leader. But a leader need not be a good manager, managing involves more than mere leading and a manager can do reasonably well even when he is not a leader. It will however be better if ability to lead is considered one of the significant prerequisites to managerial effectively. Attempts should also be made to improve leadership qualities through systematic training.

Formal and Informal Leaders

The organisation structure is characterised by hierarchy of positions which are manned by individuals in the scalar chain. Officially every manager enjoys power to lead and secure sufficient support of his subordinates. Managers are then leaders because they have the formal authority to direct, motivate and lead people. This kind of leadership is known as formal or managerial leadership and makes followers out of hirelings. However, along with formal leaders there always grow informal leaders in every organisation.

Informal leaders are not delegated any authority to lead; rather they acquire such authority as to guide and lead. Informal leadership is spontaneous and is part of informal organisation. If properly handled, informal organisation offers a good training ground for formal leaders to develop and test their leadership skills.

Approaches for Examining Leadership Behaviour

Over the years there was a great deal of speculation about leadership. Some of the most commonly raised questions include: What traits do leaders have in common

that other people do not have? What kinds of leadership styles are more effective than others? How important is it for a leader to analyze each situation and they play his game accordingly? These three questions are fundamental to leadership theory because, from the first to last, they relate to the three basic approaches that have been taken to study, viz., trait theories, style theories and contingency theories. However, it does not mean that these theories have rightly answered the three questions raised above for all practical situations. In fact, each of them has in the final analysis failed to explain enough of the difference between effective leadership to be generally useful in a variety of situations, though it contains some element of truth. The theories will be briefly discussed now.

Trait Theories

Upto little over three decades ago, leadership used to be emphasised mainly in relation to certain personal traits or qualities of the manager and a successful leader used to be conceived in terms of certain personality characteristics. It was observed that those who were commonly recognised as leaders possessed certain personal characteristics. Ordway Tead, for example, emphasised ten qualities for effective leadership namely, physical and nervous energy, a sense of purpose and discretion, enthusiasm, integrity, technical mastery, decisiveness, intelligence and faith.

The trait theory of leadership is criticised mainly on account of the following inadequacies:

(i) Skills are sometimes mistaken for traits.

(ii) No two lists agree about the essential characteristics, and interpretations of different traits also differ.

(iii) The theory fails to pinpoint the intensity and extent to which each of the agreed traits should be present in an individual.

(iv) At different times and under different situations leaders must display different leadership characteristics. Similar;y, different functions like production, sales and finance require somewhat different leadership abilities.

(v) Researches have shown that leadership should be looked beyond personal qualifications and traits of the individuals.

Style Theories

The assumption behind these theories is that employees will work harder (and therefore more effectively) for managers who employ given styles of leadership than they will for managers who employ other styles. The styles usually compared lie along authoritarian and democratic dimensions. The focus of power is the most important basis of differences among these styles. In an extreme authoritarian style, power vests with the leader who alone has the authority for decision-making, arbitration, control and reward or punishment and the right to exercise that authority as he wishes. In the democratic style, on the other hand, these powers and responsibilities are shared with the group in some way or other. It may be generally assumed that democratic styles get better performance from people as compared to

authoritarian conditions. But that may not always hold true.

Positive/Negative Leader

There are differences in the ways leaders approach people to motivate them. If the approach emphasizes rewards for followers the leaders uses positive leadership. If the emphasis is on penalties, the leader is applying negative leadership.

The autocratic leader tends to produce a negative style, the custodial model is some what positive, and the supportive and collegial models are clearly positive. Positive leadership generally achieves higher job satisfaction and performance. Negative leadership gets acceptable performance in many situations, but it has high human costs.

Negative leaders act domineering and superior with people. To get work done, they hold penalties over their people. They are bosses more than leaders. Perfection can never be achieved in style, but the trend is that managers need more and more positive leadership skills in order to be rated "satisfactory". Better employee education, greater independence, and other factors have made satisfactory employee motivation more dependent on positive leadership.

A brief survey of various contributions to style theories is made here.

(i) Lewin, Lippitt and White: Lewin, Lipitt and White conducted leadership studies in 1939 based on three different styles - autocratic, democratic, and laissez faire.

Autocratic style of leadership: The autocratic leader is characterised by centralisation of authority and decision-making in himself, and very limited participation by subordinates of the group. The autocratic leader accomplishes the results through use of authority, fear of deprivation punishment and other coercive measure.

Autocratic style is conceived by McGregor as 'hard' approach to management under Theory X. Since it is negative in character, authoritarian approach will succeed only in the short run and will fair to induce subordinates for better performance in the long run. Resentment, absenteeism and higher turnover rate for employees are some of the most natural consequences of this approach. Still autocratic style deserves consideration because:

(a) there may be very little time for participation, particular in crisis;

(b) confidential matters may not permit normal consultation; or because

(c) the leader may have more knowledge and as such may compensate for participation.

Democratic Style of Leadership: This is characterised by allowing substantial participation by members of the group in management and decision-making process of the leaders. Subordinates are frequently consulted by the manager on wide ranging problems and are allowed sufficient freedom to communicate with the leader and also with their fellow subordinates.

The sub-ordinates are also encouraged to exploit their potential and assume greater challenging responsibilities. The participation leader attaches high importance to both work and people.

Democratic style of leadership is based upon positive assumption about human beings. It encourages co-operative spirit and development of subordinates for higher responsibility. This style of leadership substantially contributes to the satisfaction on the part of subordinates.

Laissez-faire of Leadership: Under this style the leader depends largely upon the group and its members to establish their own goals and make their own decisions. The leader is passive and assumes the role of just another member of the group. Tasks are assigned in general terms.

Laissez-faire approach is meant for selective application: If the subordinate is intelligent, highly qualified and experienced, and desires self-fulfillment a manager may follow this approach without much risk. This style of leadership is, therefore, confines to a small creative or development group.

(ii) Ohio State University: Certain closely related studies for analysing leadership styles were made at Ohio State University in the mid forties. These studies identified two dimensions of leadership styles: 'consideration' and 'initiating structure'. Consideration is the extent to which job relationship are characterised by mutual trust, interpersonal warmth, and consideration for subordinates' ideas and feelings. Initiating structure is the extent to which the leader organises and defines subordinates' activities and relationships. Thus, 'consideration' is closer to democratic style whereas 'initiating structure' resembles the autocratic style of leadership.

(iii) University of Michigan: The studies conducted at this University revealed two kinds of styles viz., production centered and employee-centered, which are similar to 'initiating structure' and 'consideration' leadership styles as researched by Ohio State University Studies. These studies concludes that the employee-centered leaders were superior to production-centered leaders. Individuals who are concerned with their people first, and the task afterwards, seemed to get greater production and have employees with higher job satisfaction and morale. Conversely, production-centered leaders had lower production and employees with poorer morale and less job satisfaction.

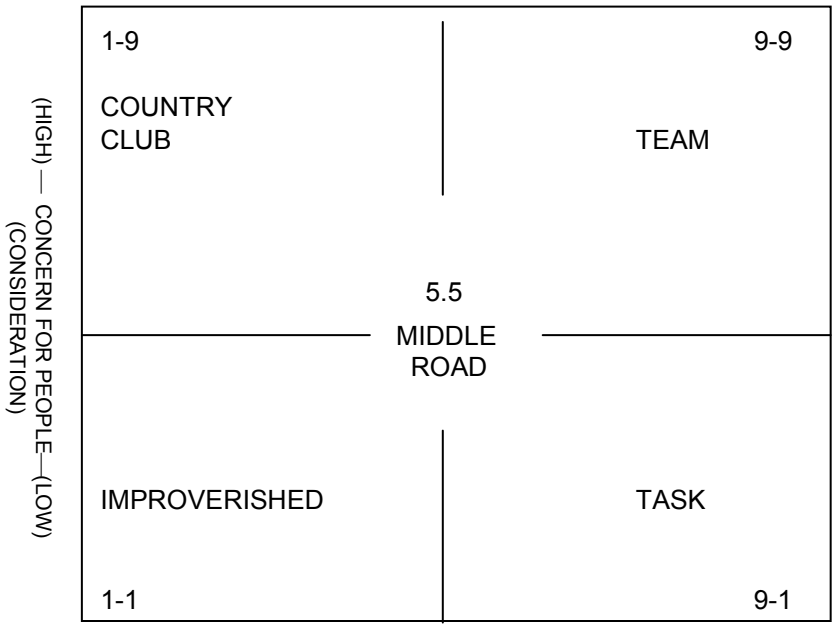
(iv) Blake and Mouton: One of the most widely known approach to dramatising leadership style is the managerial grid, developed during the sixties by Robert Blake and Jane Mouton. Drawing upon the previous research that showed the importance of a manager's having concern both for production and for people, Blake and Mouton tried to integrate these views with the help of the concept of managerial grid which is diagrammatically presented (see Fig. 7).

In the Managerial Grid five different types of leadership are located in four quadrants. The vertical axis represent a leader's concern for people (described as 'consideration' in Ohio State University studies) and the horizontal axis represent a leader's concern for task (described as 'initiating structure in Ohio State University studies). Each axis is divided into nine units 1 representing the lowest degree and 9 standing for the highest degree of concern on each scale. Theoretically, it is possible to plot 81 points on such a 9 by 9 grid, but Blake and Mouton identified five points on it as symbolising basic leadership styles. (See Fig. 7).

The five basic leadership styles are:

Impoverished: (1, 1)	Exertion of minimum effort to get required work done is appropriate to sustain organisation membership.

Country Club: (1, 9)	Thoughtful attention to needs of people for satisfying relationship lead to a comfortable friendly organisation atmosphere work tempo.
Task (9, 1):	Efficiency in operation result arranging conditions of work in such a way that human elements interfere to a minimum degree.
Middle of the Road: (5, 5)	Adequate organisation performance is possible throughbalancing the necessity to get work while maintain morale of a people at a satisfactory level.
Team: (9, 9)	Work accomplishment is from committed people; indepen Interdependence through a common stake in organisation purpose leads to relationship of trust and respect.



(LOW) - CONCERN FOR PRODUCTION
(HIGH) (INITIATING STRUCTURE)
Figure 7

Production becomes more important to the leader as his rating advance on horizontal scale. A leader with a rating of nine on the horizontal axis has a maximum concern for production. People become more important to the leader as his rating goes up to the vertical axis. A leader with a rating of nine on the vertical axis has maximum concern for his people. Thus 9,9 leadership style is typical of a manager who has a high concern for both his people and the work they do while the 1,1 style represents manager's low concern both for his men as well as the task. The 5,5 leadership style is typical of a manager who attempts to compromise his moderate concern for his people with his equally moderate concern for production results. His behavior may fluctuate between 'being tough on people to increase productivity' and

being nice to people to increase their sagging morale. Thus those who do not primarily function in one of the other four grid styles are put in 5,5 grid style'.

It may, however, be observed that in no "pure managerial grid style" individual exists. No person always transacts in a single style. Blake and Mouton realised it and so they established a concept which they call "a manager's back up style". This refers to their observation that a manager will often use one managerial grid style when initially confronting a given problem or situation. However, if this approach does not resolve things satisfactory for him, he will shift to second grid style. This grid style subsequently adopted is called the 'backup style'.

(v) Rensis Likert: Likert has identified four kinds of management systems as leadership styles: Exploitative autocracy, benevolent autocracy, consultative leadership and participative group leadership. He started his career as labourer and rose to the position of the Director of the Institute of Social Research at the University of Michigan. Through extensive research and investigations Likert and his colleagues tried to find cause and effect relationship between their measurements of management actions and the end result achieved by it. They concluded that all organisations are significantly influenced by three different kinds of variables. These are casual variables, intervening variables and end result variables.

Casual Variables: These include the factors which management can influence and change such as available technology and competence of individuals in technology, facilities, organisational policies, structure and climate, supervisory leadership and peer leadership.

Supervisory leadership according to Likert consists of four factors:

(a) supportive leadership style,

(b) emphasis on high performance aspiration and goals,

(c) time and effort spent on team building, and

(d) work facilities.

Whether or not the experience is supportive will be determined, according to Likert, from the subordinates perception of the situation rather that the supervisor's perception. He emphasises peer leadership equally with supervisory leadership in accomplishing work group goals.

Intervening Variables: The factors which reflect the internal state and health of the organisation are intervening variables. These include motivation of individuals, individual and group problem solving, decision-making, co-ordination and communication.

End Result Variables: These depend on casual and intervening variables and reflect the observable achievements of the organisation. Productivity, costs, earnings, scrap loss and quality performance are the end results. Employee turnover,

grievances, employee attendance and satisfaction also reflect efficiency and effectiveness of total management system.

The above variables are not independent. Each of them influences at least one or more of the other variables and collectively they tend to operate like a closed loop system as shown in the diagram.

Measurement of Variables: Likert and his associates constructed questionnaires to obtain employee perception of casual and intervening variables of management systems in which they work. Each item on the questionnaire is constructed as a continuum. At one end of the continuum, the described behaviour is of an exploitative authoritative nature labelled as system I. At the opposite end of the continuum the described behaviour is characterised by a high degree of individual participation, called as system IV. The two intermediate kinds of management behaviour which fall between the two extremes are benevolent authoritarian and consultative described as systems II and III respectively.

System I	System II	System III	System IV
Exploitative Authoritarian	Benevolent Authoritative	Consultative Democratic	Participative Democratic

System I is a task oriented highly structural authoritarian management style: System IV is a relationship oriented management style based on team work, mutual trust and confidence. Systems II and III are intermediate stages between two extremes. Management in system II is seen as having condescending confidence and trust in subordinates, such as master has towards servant. System III is seen as having substantial but not complete confidence in subordinates. Decision-making is highly centralised in system I but widely dispersed in system IV. Fear, threat and award are used to motivate employees in system I while participation and involvement are the principal motivating forces in system IV. In this system control process is highly centralised in top management. In system IV there is a wide spread responsibility for control process.

On the basis of observations and investigations, Likert came to conclusion that the closer the management style of an organisation approaches system IV, the more likely it is to have a continuous record of high productivity, improved quality of work, better earnings and better employee morale and discipline.

To conclude, division of leadership in terms of separate styles is important for identifying two primary roles of the leader. The first is to see that the work of the organisation is accomplished. The second is to ensure that the activities necessary to maintain the group are carried out. If conflict and hostility destroy co-operation, then obviously the goals will not be achieved. However, a manager is not always free in the choice of leadership style most appropriate to him under a given situation. Feelings and attitudes long cherished are difficult to change. Though democratic style of leadership works better as a pattern for general purpose, the manager should be able to occasionally switch to the autocratic style so that people are effectively led. In general, choice of the pattern or style of leadership depends upon:

(i) Skills, personality and values of the manager himself.

(ii) Forces dominating the subordinates like subordinate's expectations, aspirations, needs and values.

(iii) Situations, such as type of structure, clarity or ambiguity in defining work and objectives, nature of the problem and the pressure of time.

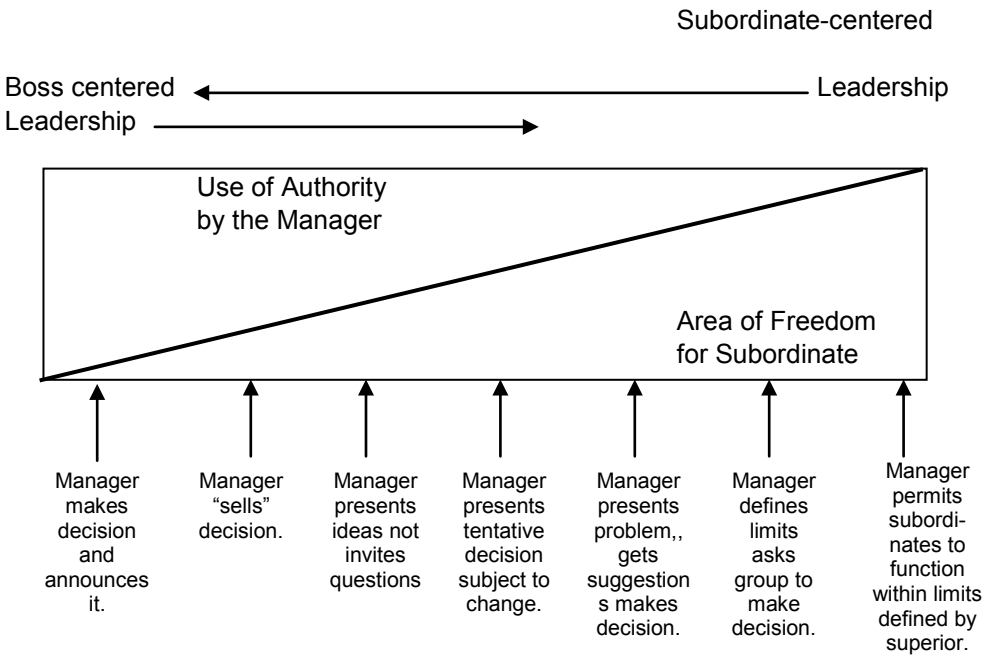
(iv) People in the group, e.g., differences in education, interest, motives, loyalty and the like.

Thus, leadership style varies with different leaders, subordinates and situations.

Situational or Contingency Theories: The inability to find any one set of traits that constitute leadership or any one style that is appropriate under all conditions soon led researchers and others to conclude that leadership was situational. Situational or contingency theories of leadership started to develop in 1950s. It began to be recognised that the leader's qualities and behaviour cannot be separated from the environment. Contingency theorists take more specific account of the other variables involved in any leadership situation, in particular the task and/or the work group and the position of the leader within that group. As such, according to contingency theorists, individuals will be leaders in some situations but not in others, and different leadership styles are related to the conditions associated with different organisations. Three significant contributions to these theories are stated below:

(i) The Tannenbaum-Schmidt Continuum: Robert Tannenbaum and Warren H. Schmidt published an article in 1958, associating situations factors to be boss centered or subordinate-centered leadership styles. The leadership continuum and associated conditions are shown in Figure 8.

On the extreme left, under boss-centered leadership, the manager makes most decisions. Little freedom is permitted for subordinates. As we move along the continuum to the right, subordinates are more involved in decision-making and they have greater freedom of action.



Robert Tannebaum and Warren H. Schmidt. How to choose a Leadership Pattern, Harvar Business Review, March-April 1958. Copyright 1958 by the President and Fellows of Harward College all rights reserved.

Figure 8

What would be the most suitable point along the continuum for any leader? That depends on three sets of forces: Those in the manager, in subordinates, and in the situation. Forces relating the manager include that persons' value system, confidence in subordinates, leadership urges, and need for certainty. Forces associated with subordinates are their desire for independence, willingness to assume responsibility, knowledge, interests in the tasks, identification with the goals of the organisation, and expectations of sharing in decision-making. Forces in the situation consist of the type of organisation, group effectiveness and cohesiveness, the nature of the problem under consideration, and the pressure of time.

This approach is significant is as much as it suggests many factors which determine whether a directive or more participative approach will be effective in a group.

(ii) Fiedler's Contingency Theory: Fiedler's contingency approach is the result of the most extensive programme of research with regard to leadership styles and effective group performance carried out by Fred E. Fiedler originally at the University of Illinois and more recently at the University of Washington.

Managerial personality forming the basis of this theory is best described as ranging from a strong task orientation at one extreme to a strong human or interpersonal relations at the other extreme. In relation to the organisation managerial personality is

viewed as emphasising either task or maintenance. Whether a task-oriented or people-oriented leadership is the best is viewed as contingent more upon the nature of the situation than upon the individual himself.

The situational variables considered by this research are:

(i) *Leader-Member Relations:* These are good or bad depending upon leader being liked or disliked by the group being supervised.

(ii) *Task Structure:* It is said to be high or low depending upon the extent to which work to be done and goals to be achieved are defined clearly and unambiguously.

(iii) *Power Position:* It is strong or weak depending upon the amount of reward and coercive and legitimate power possessed.

A major conclusion of Fiedler's contingency theory is that production oriented leadership is most efficient in either highly favourable or highly unfavourable situations from the viewpoint of the leader. Unfavourable or difficult situation is encountered when things are not clear, and work to be done and goals to be achieved are ambiguous and have to be specified by the leader. Under this situation a task-oriented leader is required. A task-oriented leader will also be more successful when things are clear and simple. In the intermediate situations, i.e., those lying in between the two extremes of highly unfavourable or highly favourable situations a manager who gives more attention to maintenance considerations (that is, who is people-oriented), is likely to do better.

Leader-member relations, structure, and position-power are the three critical factors considered by this theory as defining the situations that influence orientation of a manager. There are, however, other situational factors like group performance, etc., which has a substantial bearing upon the pattern of leadership style.

(iii) Path-goal Theory of Leadership: The third contingency theory of leadership is the path-goal theory originally proposed by Robert J. House who later refined and extended it in collaboration with Gary Dessler. The model is based on Vroom's theory of motivation, incorporating such key concepts as expectancy, valence, and instrumentality, although these specific terms are not used.

According to this theory, the leader's job is seen as being one of (a) clarifying the tasks to be performed by the subordinates, (b) clearing away any roadblocks that prevent goal attainment, and (c) increasing the opportunity for the subordinates by obtaining personal satisfactions. In accomplishing these three activities, the "best" style of leader behaviour is seen as a function of the individuals and the task. In essence, this approach finds that the most effective leaders are those who help subordinates achieve both enterprise goals and their personal goals particularly achievement and reward goals such as money, promotion, interesting tasks, and opportunities for growth and development, etc.

Conclusion: A review of various leadership theories leads one to the conclusion that it would be the ideal case when a leader is able to identify all the possible situational variables and their interrelationship for becoming effective. But the real

difficulty lies in really applying this ideal to real management situations. However, one would definitely agree that 'leadership effectiveness' is what matters in a leader's life. The leader must study each situation, as deeply as he can, to become effective.

Cultivated Leadership Attitudes

Since leading people involves interpersonal relationships between the leaders and the followers, leader should always try to improve his attitude towards the led to become effective. This becomes even more important than mere knowledge because certain behavioural patterns can be learned and used with skill. Some such behavioural patterns are:

(a) *Awareness:* The manager should not do his job of leading unimaginatively, without being aware of the factors which account for success or failure. He must know his job, the people involved and the situational considerations clearly to ensure effectiveness. But knowing and being knowledgeable are not enough. He must also process the ability to apply this knowledge to get practical results.

(b) *Empathy:* It is generally described as ability of a person to look at things or problems from another person's point of view. It involves projecting one self into the position of the subordinate who are being directed and led. Manager should not assume that subordinates will understand the things and problems as he himself perceives them. People differ in their experience, ability and understanding of things. Each has his own value system and attitudes. Thus, in order to understand their feelings and problems, to lead them successfully, manager should put himself in the position of subordinates.

(c) *Objectivity:* In his task of leading the manager should not be guided by any preconceived notions about the attitude and behaviour of his subordinates. Problems and their causes should be observed very objectively and unemotionally. Thus a manager should not be annoyed with his subordinates simply because results are poor or change is resisted. He must observe the things as they are and analyse them very objectively. It is only when a manager is objective and detached in his behaviour towards members of the group he would be able to assess their feelings and problems and guide them properly. But this behaviour needs to be learnt.

(d) *Self-knowledge:* A manager may think himself to be fair and objective but subordinates may view him otherwise. He should, therefore, know for himself how he appears to others and effect of his attitude and behaviour on the subordinates which would help him lead in a pattern as perceived by those who are being led. Self-knowledge will help the leader to improve and cultivate those habits and attitude that produce favourable response on the part of subordinates. For instance, if self-awareness leads him to learn that instructions are not properly understood, the manager can attempt to improve his ability to communicate.

Functions of Leadership

Leadership is a means of directing and represents that part of executive activities by which he guides and influences the behaviour of his subordinates and the group towards some specified goals by personally working with them and understanding their feeling and problems.

In recent years management experts, psychologists, sociologists and behavioural scientists have tried to identify the functions of leadership in varied ways and from different view points.

Sociological view: Among the sociologists who went into deep to study the functions of leaders, of P. Selzink may be attended to at the first opportunity. He viewed leadership function in setting goals, shaping and reshaping organisation and reconciling internal and external forces. In fact, it is the creative function of the leader that calls for viewing and reviewing organisation environment, work accomplishment and determining near and remote goals in the above perspective.

Nevertheless, review of the work of other sociologists bring to the fare the view that the leader is supposed to build goals and determine policies into the social structure of the enterprise. It is his fundamental duty to see that the enterprise does not merely survive; it grows into a stature. Leaders should be in a position to read the desired changes, movements and functions of the enterprise to get it placed in the industrial complex. Another important function, however, is to manage and mitigate internal conflict. It is a hard fact that conflict is imminent in big organisation due to diverse opinion, views, belief and values. The effectiveness of leaders lie in their endeavour to win the consent of several groups and put them to work in accomplishing the objective and the enterprise mission in the ultimate analysis.

Psychological View: In the opinion of psychologists people will best respond in terms of output if the organisation provides opportunities for them to appraise and appreciate their basic social and ego needs. As a matter of fact, one of the basic functions of the managers and executives, leaders, in other words, is to devise the necessary motivational system to meet their needs. It should, however, be kept in view that though the above arrangement is sound from the viewpoint of motivation, it is not adequate to outline or specify the scope in precise for the exercise of leadership on the part of the manager.

Other Views: Management experts, of late, have given a lot of attention in identifying the exact function of leadership. From the study of management experts leadership function can be viewed as consisting of (i) directing, (ii) responding, and (iii) representing.

Eminent scholar Leornard Sayles viewed directing as the primary function of leaders. In big organisations where divergent views and number of groups exist, it is essentially through the means of directing that all of them are unified and co-ordinated for a central purpose. In this matter, of course, managers and executives have to take the required initiative with intelligent approach and rational attitude. Approach and attitude are particularly important in this respect since too much of initiative is not desirable in the sense that subordinates may be thrown in a dilemma with the resultant effect in crippling accomplishment of goals. In essence, judgement

is required in view of new actions to be initiated or accomplishments undertaken. Managers and executives are required to initiate those matters in a way so that enthusiasm and zeal of subordinates are enhanced.

Management experts consider responding as the second function of leadership. It signifies responsiveness to the initiations of subordinates. It may often be noticed that subordinates off and on ask for guidance, assistance advice and help from their superior. Moreover, subordinates always want to be assured that their case is referred for reward and promotion in recognition to their service rendered. Generally, the superior in the ordinary course of his management capacity provides necessary aid in response to them. But there is no denying the fact that adequate leadership skill enables the executives to take more initiative and drive, exert endeavour skillfully to the purpose. However, in a precise manner it may be asserted that leadership quality helps superior to appraise the needs of their subordinates and meet them intelligently.

The other essential function of leadership as has been underlined by the management experts is representing. It signifies that superiors would properly and effectively represent interests of the total group among their peers and to higher level in the managerial hierarchy. This aspect of subordinate thinking may very commonly be observed where subordinates initiate action that requires to be accomplished by their superiors or higher level personnel. In fact, leadership quality enables the executives or represent such group effort and get positive response.

Thus, it may be stated now that effective leadership by providing the social skill transforms the management into a social process. Success of leaders depends on how well they are able to persuade employees to follow this social process with unified interpretation, outlook, initiative and enthusiasm. Effective leadership undoubtedly creates a will-to-do environment among the employees by responding to their problems, feelings, aspirations and ambitions. On the other hand, it enhances the image of the organisation to the outside world.

Hence, executives and managers must posses leadership skill to keep their department dynamic, healthy and consequently the organisation lively.

SELF-TEST QUESTIONS

1. Define motivation. In what sense is this term different from “motives” and “motivators”. Also state the concept of “Need-want-satisfaction chain”.
2. “Without understanding peoples’ motivation, a manager cannot be successful”. Comment.
3. What is the relationship of motivation with human behaviour? In what away does the “Transactional Analysis” helps in understanding behaviour?
4. Discuss the distinguishing features of various theories of motivation and explain how each theory is useful for managers.
5. How is morale related to productivity? How will you proceed to ascertain the state of current morale of your subordinates?

6. “Leadership is situational”. Discuss.

7. A successful chief executive claims that “his door is always open” and that he will always meet any staff member or employee who wants to see him. Discuss this attitude and some of its more import-consequences.

Suggested Readings:

(1) Human Behaviour at work — *Keith Davis*

(2) Management of Organisational Behaviour — *Paul Hersey & Kenneth H. Blanchard*

(3) The Human Side of Enterprise — *Douglas McGregor*

(4) Understanding Organisations — *Charles B. Handy*

STUDY XVII

CONTROL AND ITS PROCESS

DEFINITION AND NATURE OF CONTROL

Control is a fundamental managerial function that usually follows other functions. But like planning and other functions, control is also a continuing process of management. By forcing events to conform to plans, control becomes intimately connected with planning and has the same characteristics of unity, continuity, flexibility and pervasiveness as are possessed by planning. If plans were left to themselves, objectives of the enterprise would be difficult to accomplish. To achieve organisational objectives and to complete various company plans, managers have to regulate work assignments properly, review work progress, and to check operations lying within their jurisdiction. Controlling as a function of management, therefore, means the measurement and correction of performance of activities of subordinates in order to make sure that enterprise objectives and plans devised to attain them are accomplished. Control thus consists in knowing the extent to which actions are in conformity with plans adopted and instructions issued so that errors and deviations are promptly reported and analysed, and suitable corrective actions taken. Remedial action may result in alteration of plans, change in the organisation structure, modification in the staffing process, or change in the process and techniques of direction.

Control depends on, and Contributes to other Functions of Management

Without plans to set objectives and specify activities, control would serve no useful purpose; without organisations, there would hardly be any guidance about who should make evaluations and who should take corrective action; in the absence of effective direction, corrective action would have little or insignificant impact on actual performance. Thus, different phases of management process need to be effectively linked together.

Control presupposes the existence of goals and plans. Accordingly, no manager can control actions which are not planned. Thus, complete and co-ordinated plans greatly facilitate the control process.

Control Pervades all Levels of Management

In view of the authority vested in the managers occupying top positions in the organisation and their consequent responsibility, control is sometimes considered to be the function of top management, and many are under the impression that little control is needed at lower levels. But this is erroneous and misleading. Although the nature of control exercised by the managers varies, it is an essential function of management performed at all levels in the organisation.

STEPS/ESSENTIAL ELEMENTS OF CONTROLLING

Control consists of assuring that the results of operations confirm as closely as possible to the established goals and predetermined standards. The essential elements of any control process are:

— Establishment of goals and standards

— Measurement of Actual performance against standards

— Corrective action

— Follow through action.

Establishment of Goals and Standards

Standards are the norms against which the performance is measured to find out the result. The first essential element of any control process is to know what should be the result. This requires projecting the future and determination of goals and standards of performance. Standards may be tangible or intangible, abstract or specific. But these must be so expressed that people concerned understand them, and that accomplishment of assigned duties can be measured against them. Standards relating to factors like employee morale, loyalty, result expected of a training programme and public relations cannot generally be stated in quantifiable terms. Such intangible and somewhat abstract standards need special care.

In view of the large number of standards which can be established to judge performance, it is sometimes suggested that standards should be set at strategic control points. While selecting strategic control standards, management should be economical, comprehensive and balanced. Managers should also bear in mind that control standards prove more effective when related to the performance of different individuals. This helps the superior and subordinate as well to correctly appraise the performance and fix responsibility for deviations.

Measurement of Actual Performance against Standards

Once standards are set, the second basic step in control process is the evaluation of performance. This requires measuring the work in terms of control standards, and communicating the appraisal to persons responsible for taking corrective actions. Measurement of performance must be in units similar to those in which standards are expressed.

Measurement of performance is often described as a mere post-mortem of past events. However, checking on performance is not intended just to determine that a mistake has been made, rather it enables the manager to predict future problems. A good control system will also provide required information through the process of feedback so that the cause behind deviations can be diagnosed and corrected instantaneously. A forward-looking control can even sometimes predict the probable deviations from the standard well in advance. In so developing and designing the control system, management is solely motivated by the desire for prompt action. Customer inquiries are sometimes used to predict a rise or fall in sales: a machine's vibration may be used to predict a breakdown; or grievances may be used to predict a strike. Through such prediction, corrective actions can be initiated without waiting for the actual event to occur.

Measurement of performance becomes easy if appropriate standards have been set and means are available for exact determination of the performance. But in practice there are some activities for which it is extremely difficult to develop sound standards. Likewise, there are many performance areas that are difficult to measure.

Industrial relations, finance, and public relations are a few examples of this kind.

Thus, setting appropriate standards and developing the means for exact measurement and appraisal of performance is an extremely difficult task; nonetheless, managers at all levels develop verifiable objectives, expressed either in quantitative or qualitative terms. These objectives are used as standards against which performance at different levels in the organisation can be measured. Moreover, as new techniques are being developed to measure the performance with a reasonable degree of objectivity, useful standards at higher as well as lower levels of management are bound to emerge. Management should also apply the exception principle and concentrate mainly on significant deviations wherever they occur.

Corrective Action

When a significant discrepancy occurs between the actual output or performance and the planned or predetermined performance standards, specific action must be taken to correct the situation. Some innovative people and organisations have already built-in corrective actions in their control process, if the deviations are due to controllable factors. Some even go to the extent of identifying the uncontrollable factors and developing alternative courses of action for deviations. When deviations occur and the procedures regarding corrective action are given in advance to the performers of job, actions can be taken without delay. The following are important phases of corrective action.

1. The Operation Phase

(a) Prompt investigation of the causes of the deviation.

(b) Decisions concerning the required corrective action.

(c) Prompt direction for correcting the situation in accordance with the decision.

(d) Close supervision of the corrective action to ensure that it is taking place according to the instructions and is effective.

2. The Administrative Phase

(a) Further investigation of recurring difficulties to determine the basic factors, either human or physical, that are responsible.

(b) Disciplinary action, either positive or negative, as the situation requires.

(c) Creative planning to prevent a recurrence of the situation.

(d) Recognition of the situation and the introduction of the planned measurement.

Follow-Through

Recommending corrective actions also is not sufficient and the manager shouldn’t assume that his responsibility is over with this action. Often the control process is ineffective or fails because the corrective action recommended is not followed through. Specific procedures must be established and the responsibility must be clearly assigned to carry out the corrective action. Say, for instance, the performance evaluation of a subordinate indicates weaknesses in supervisory practices, the superior of this individual recommends a correction action by which the individual is to undergo some training in supervisory practices. The responsibility for that corrective action is not

over just by making this recommendation. The superior must follow through his recommendations to see whether the individual participates and makes progress in the training programme and to what extent he relates to his actual work situation whatever he has learned in the training programme.

REQUIREMENTS OF EFFECTIVE CONTROL SYSTEM

Certain ideas are basic to the development of an effective control system and every manager irrespective of the level at which he operates must be guided by these considerations.

(1) Feedback

Feedback is the process of adjusting future actions based upon information about past performance. The idea of feedback is applied in various disciplines. Thus, the electric engineer talks of “closed loop” system where information relating to actual performance is feedback to the source of energy by electric or mechanical means in an endless chain. The idea is to make the control instantaneous. The social psychologist talks of the open loop system where the human being adjusts future operations through supply of energy in the light of information of actual performance.

Feedback is based upon inter-dependence of different parts of a system. The classical illustration of a thermostat (control device of the closed loop type) highlights the essential features of the principle of feedback. The thermostat records actual temperature in a room, compares it with the required or planned temperature. This information is then referred back to the source of heat (the furnace), and the temperature is accordingly adjusted through closing or opening a valve.

Managerial control is somewhat akin to the thermostat system of a furnace though it directs its attention to the open loop system. A manager responsible for control needs a continuous flow of information relating to actual performance so that deviations are promptly detected and corrected. Information which flows back to the manager for this purpose is nothing but feedback. Information may be feedback informally or formally. Informal feedback is through personal contact, informal discussions and personal observation. Financial statements, reports, statistical analysis, and other written communications furnish examples of formal feedback. In every organisation information is feedback formally as well as informally.

Whatever be the efficiency in date feedback, managerial control cannot be so instantaneous or self-correcting as some of the mechanical or electronic control are. There are, however, managers who on the pretext of automatic correction of deviations, favour new and sophisticated systems of data collection. These managers overlook the fact that there always exists a time-lag between recording the deviations and initiating the corrective actions. Even when deviations are promptly reported, it takes time to analyse them, chalk out a programme of actions and implement the same. A major part of the time in correcting deviations is consumed in these three separate identifiable activities, and not so much in recording and reporting of deviations.

Thus, even fastest data collection, such as the “real time” information (i.e. information immediately available at the time events are occurring) will not result in automatic correction of deviations from plans.

(2) Control should be Objective

Evaluation of the performance of a subordinate should not be a matter of subjective determination. That is, control, should be definite and objective. A subordinate will respond favourably to the objective standards and impartial appraisal of his work performance.

(3) Prompt Reporting of Deviations

Control system should be devised so as to detect deviations before they actually occur. Manger should be provided with information as soon as possible so that he can hive off failures.

(4) Forward-looking Control

Ideal control is instantaneous, self-correcting and forward-looking. However, managerial control is not exactly similar to the mechanical or electronic control. There normally exists a time-lag between recording and reporting the deviations and the corrective actions to become operative. A manager should, therefore, structure his control system in a way so that deviations are predicted well in time and corrective action can be initiated before substantial deviation occur.

(5) Flexible Control

Control must be flexible in the sense that it should respond favourably to the conditions. In consequence of unforeseen circumstances when plans are changed, control should reflect corresponding changes to remain operative under new conditions. Controls are not an end in themselves. In order to accomplish objectives if it becomes necessary to revise the plans, the control system must have the attribute to adapt itself to new developments. The basic idea is that control should remain workable under dynamic business conditions including the failure of the control system itself. Flexible plans tend to make the control adaptable to new situations.

(6) Organisational Suitability

Control is exercised through managerial positions, and as such they should reflect the organisational pattern. Each managerial position should be provided with adequate authority to exercise self-control and take corrective actions. Flow of control information should be consistent with organisation structure employed.

(7) Control should be Economical

A control system should be economical in the sense that the cost of its installation and maintenance should be justified by its benefits. Simply stated, control must be worth its cost. An elaborate control system may sometimes have to be discarded because cost and benefit considerations do not warrant its installation. Thus, a small company can hardly afford the extensive system of control practised by

large companies.

(8) Strategic Point Control

Deviations cannot be eliminated altogether. However, all deviations are not of equal importance and do not require same account of attention. Thus, if postal expense has rise by, say, 10 per cent, this deviation is insignificant and carries very little meaning for the management. If, on the other hand, labour cost rises by only 5 per cent, this must occupy full attention of management. An attempt to control and attend to all the factors will make the management busy with less important problems and deny management attention to the strategic areas and deviations. It is thus one of the essential requirements of an effective control system to highlight the critical or limiting points that deserve close management attention for appraisal and adjustments. Thus, efficient control system discriminates between important and unimportant factors, and through it makes the system more effective and less costly.

(9) Control should be simple to understand

Those who administer control should understand it. Control specialists very often recommend sophisticated and advanced techniques of control on the pretext of proving their expertise, and tend to overlook the question of their being understandable to managers in the organisation. There are also cases where the personnel lack sufficient motivation to learn the new system. In either case, control loses its effectiveness. Thus, while launching a system of control. Management should take into account the present qualifications and abilities of executives and also their potential abilities to be developed soon. It is further to be noted that any such tool is properly understood by all those who have to manage it. Mathematical formulae, complex charts and detailed statistical summaries, though very useful, may fail to prove as effective control devices if their meaning is not properly communicated to the executives who have to use them.

(10) Control should suggest Corrective Action

An essential requirement of the effective control system is that it should indicate deviations and suggest corrective actions promptly and in time. Simple recording of deviations and errors and fixing responsibility for their occurrence is not sufficient if it is not followed by suitable actions to prevent its further occurrence.

(11) Worker-focussed Control

Modern control system is worker-focussed rather than work or job oriented. Control is effected on people who handle material resources for producing certain work results. If any corrective action is called for, persons accountable for results are to be located for initiating remedial actions. Research studies have proved that because of greater freedom allowed and special interest shown by it in the people worker-focussed control is generally associated with higher productivity.

BUDGETARY CONTROL

A variety of tools and techniques have been developed and used for the years for purposes of managerial control. These tools are, in the first instance planning devices. Some of these techniques are termed as traditional and others as modern.

Most of the modern control devices usually reflect the system techniques long used in physical sciences. Operations research and PERT (Programme Evaluation and Review Technique) are important modern control techniques.

Despite the newer techniques of planning and control, some of the traditional techniques are still very popular because of their special significance and continuing utility. Budgeting is one of the most important of such devices.

Budgeting and budgets have long been used as important tools for planning and controlling. Budget as a plan represents a statement of expected results expressed numerically. The Institute of Cost and Management Accountants of England and Wales defines a budget as “a financial and/or quantitative statement prepared prior to a defined period of time of the policy to be pushed during that period for the purpose of attaining a good objective”.

Expected results in a budget may be expressed in financial terms, in terms of man hours, units of output, machine hours, or in any other numerically measurable term. A budget may deal with operations, such as the expense budget; it may relate to capital outlays, like the capital budget; or it may reflect flow of cash, as does the cash budget.

Budgeting refers to making of a plan or the budget relating to different phases of operations for a defined period in the future. It is, therefore, the fundamental instrument of planning. However, the budget and its administration represent the control process of management. And exercising control over day-to-day operations of the enterprise on the basis and for the purpose of executing budgets is known as budgetary control. The Institute of Cost and Management Accountants of England and Wales has defined budgetary control as “the establishment of objectives relating to the responsibilities of executives to the requirements of a policy and the continuous comparison of actual with budgeted results, either to secure by individual action the objective of that policy or to provide a basis for its revision”.

Size of the enterprise does not affect the essentials of budgeting, though in a big organisation with comprehensive budgeting, the budgetary system tends to become more complex. Full benefits of budgeting and budgetary control can be realised if different phases of all the operations of the company are covered by budgets and comprehensive budgeting is in use. In such cases, planning is largely confined to budgeting. In a number of enterprises, however, only important activities are planned and controlled by means of budgets, and only partial budgets are prepared. Sales budgets are generally prepared in either case.

(A) Elements of Budgetary Control

Basically, budgetary control involves the following steps:

(i) Determination of objectives to be achieved. The objectives may be higher profits, better finance position, better position in the market, etc.

(2) Noting the steps necessary to achieve the objectives, i.e., laying down the exact and detailed course of action month by month and over the whole period.

(3) Translating the course of action into quantitative and monetary terms. This means drawing upon the budgetary statements.

(4) Constant comparison of the actuals with the budget (again both physical achievement and the money values involved). Deviations and their reasons are to be noted. Steps to remove causes of deviations, shortcomings, wastages, losses, etc., are to be taken and to consolidate reasons leading to results.

(B) Purpose of Budgeting

Budgeting is used for a variety of purposes. Thus, according to Koontz and O'Donnel, "budgets correlate planning and allow authority to be delegated without loss of control". Some of the basic general purposes for which budgeting is used are as follows:

(1) To Develop an Organised Procedure for Planning

Budgeting is used as an aid to planning and budget is sometimes known as the profit plan. A budget requires planning and is also in itself an instrument of planning. Budgeting involves anticipation of results and expressing them in numerical terms. The revenue and expense budget, for examples, requires compilation of sales budget and a number of different expense budgets. Forecasting or projecting a future course of action implied in budgeting is essentially a planning process. Comprehensive budgeting forces in management to develop a network of objectives and policies and plans for all the phases of operations of the enterprise.

(2) Means of Co-ordination

Budgeting is also used for coordinating the activities of the various divisions of a business. Thus, production must bear a logical relation to sales. While preparing budgets information must certainly be required relating to divisions and activities in the enterprise. A sales budget, for instance, cannot be prepared without knowing about production programme of the enterprise. The very act of preparing budgets, therefore, forces coordination. The process of integrating various budgets into a master budget also highlights the importance of coordination implied in budgeting.

(3) A Basis for Control

Control represents the most widely known use for budgeting. Events can be compelled to conform to plans only when there are predetermined objectives and standards. Budgeting forces management to lay down objectives, goals and plans in numerical terms. It thus provides the yardstick for measurement of performance so essential for effective control. Budget reports analyse the deviations and also suggest corrective actions. thus, budgeting is also used as an aid to managerial control.

Stated above are the general or overall purposes of budgeting and budgetary control.

However budgets are also used for a number of other specific purposes:

(1) To Control Cost

Individual budgets for each operation or departmental help the management to know separately the cost for each of them and thus exercise effective control over

cost. The departmental manager who notices substantial deviations from budgeted costs for operations under his control, feels compelled to curtail extra expenditure and think very seriously about controlling the cost.

(2) To Increase Efficiency in the Field of Production

Very often than not, budgetary control necessitates preparation of separate production budget, and thus helps determine progress and efficiency of the production.

(3) To Determine Capital Requirements

Budgeting is also employed to determine capital requirements of the enterprise. This is possible through computing financial flows at different phases of all the operations of the enterprise as reflected in various budgets.

(4) To Encourage Research and Development

Budgeting also aims at encouraging research and development. Comparison of actual performance with the budgeted goals and plans, and thorough analysis of deviations particularly of key factors provide a sound basis for research and development.

(5) To Increase Utility of Cost Records

Budgeting entails considerable use of cost information and records. Thus, budgetary controls adds meaning to cost records and increase their utility.

(C) Types of Budget

Budgets are drawn on the basis of plans and since an average enterprise has a large variety of plans, there are many types of budgets currently in use in business organisations. The following are the important types of budgets.

(1) Sales budgets including selling and distribution costs budgets.

(2) Production and manufacturing budgets comprising of -
   (a) Direct Material Budget.
   (b) Direct Labour Budget.
   (c) Factory Overhead Budget.
   (d) Pant Utilisation Budget.

(3) Purchase Budget.

(4) Capital Expenditure Budget.

(5) Administration Expenses Budget.

(6) Research and Development Budget.

(7) Cash Budget.

Normally, the first budget to be drawn up is that regarding sales. The sales department of the sales manager will present various alternative possibilities of sales, especially if there are a number of products - it is always possible to reduce the sale of one product and increase that of another by means of controlling the marketing mix variables. Management has then to choose the best sales budget, keeping in view the production facilities and the cost and price structure. While

preparing the sales budget, both internal and external factors should be considered and evaluated. External influences reflect general trend of the industrial activity, government policies, business cycles, population, and changes in buying habits and modes of living. Sales trends, production capacity, laying down quotas for salesman, sales-territories, seasonal products, and plant expansion constitute the important internal influences.

The production budget determines the quantity to be produced, the material budget details the direct materials required to manufacture finished goods, and the labour budget lays down the number and types of workers needed. Indirect labour requirements are generally included in the factory overhead budget along with other indirect work expenses. The capital expenditure budget indicates funds involved and the time required to recover the investment. Even where budgeting is overlooked, budgeting capital expenditure is seldom neglected. Administration expense budget is a forecasts of administrative expenses as divided into different sub-heads for the budget period. While developing the research and development budget, management must consider the costs of research and development activities from both the long and short- range point of view. The value of research and development programme must also be clearly projected. Cash budget is forecast of cash receipts and disbursements for the budget period.

The Budgeted Balance Sheet

The budgeted balance sheet indicates the effect of the various budget plans of operations on the status of assets, liabilities, and capital account as on particular dates in the future. The chief finance officer is generally responsible for compiling the budgeted balance sheet. Since changes in balance sheet items occur because of the various other budgets, the budgeted balance sheet proves the accuracy of all other budgets.

A master budget is frequently prepared to combine all other budgets in a summary form. The components of the master budget are the various functional budgets. The summary plan of master budget is generally divided into two parts- a forecast income statement and a forecast balance sheet.

The Budget Committee

Success in budgeting calls for full cooperation of all executives concerned with budget preparation and implementation. In many enterprises this co-operation is secured through establishing a budget committee. Guiding principles are laid down by the chief executive, and the direction and execution of all budget procedures are generally delegated to the budget committee. However, the budget committee may be constituted in a staff capacity or as a line committee. Thus, budget committee may be of an advisory nature making recommendations to the tope management concerning budgeting. It may also be constituted as a line committee to consider all departmental estimates, make necessary revisions in them, and approve them for implementation. In a manufacturing company the budget committee usually consists of executives in charge of major functions of business and includes the sales manager, the production manager, the treasurer and the controller, etc.

The usual functions of the budget committee are to:

(1) Receive, review and suggest revisions in individual budget estimates.

(2) Approve budgets and offer revisions, if required.

(3) Formulate and announce general policies.

(4) Receive and analyse budget reports.

(5) Suggest necessary corrective actions to improve efficiency.

The budget committee is normally constituted as a standing committee with a budget director in charge of the procedures by which the budget is developed.

Flexible Budget

Even though all the effort is made to see that the actual performance in a year conforms to what was budgeted, it is not unoften that conditions change materially. Suppose, sales are budgeted at 1,00,000 units, it is possible that the actual sale may run at a figure much higher or much lower than this. It is obvious that in such a case implementation of the system of budgetary control on the basis of budget already drawn up for 1,00,000 units will not be useful; rather, it may give rise to misleading results. It is necessary that a budget appropriate to the actual level of sales be quickly drawn up. A system of budgeting which permits this sort of revision is known as flexible budgeting.

A firm may secure flexibility in budgeting by following the system of alternative budgets. Thus, a company may have three sets of budgets - one for high level operations, another for medium level, and the third for a low level of operations. Flexibility may also be secured by preparing only two budgets: One for a high level and another for a low level of operation. Various items may then be estimated by means of interpreting between the two alternatives.

Flexible budgeting will require that all the costs should be studies in order to assess the degree of variability of the item. Some expenses are totally fixed, others are totally variable, but a very large number of expenses are semi-variable. In this last group of expenses, various items will behave in different manner - some expenses may change by 4% when sales increase by 10%, some by 5%, and so on. Such expenses have to be carefully studied. It is only on the basis of degree of variability of different items of cost that the budgets can be quickly recasted to suit actual conditions.

(D) Benefits of Budgeting

A system of budgeting and budgetary control leads to the following advantages:

(i) Budgeting helps to express many diverse actions and things in terms of a common numerical denominator. It thus provides the management with a means of making comparisons between dissimilar things.

(ii) Maximum efficiency is achieved by avoiding wastage and losses.

(iii) Expenditure beyond what is provided in budgets is not incurred without prior sanction. Thus, expenditure can be scrutinised before it is incurred.

(iv) Budgets serve as a target. Therefore, objective judgement, rather than judgements depending upon personal ideas and whims, is possible. The people concerned also know the standard against which their performance is supposed to be judged.

(v) Every one knows what exactly he has to do. This means there will be no over-lapping and that there will be nothing left undone.

(vi) Management by exception is possible; comparison of actual and budgeted performance will show up spots where management attention is needed the most.

(vii) If budgets are drawn up on the basis of measured dynamism, the firm would be able to grow at a faster rate.

(viii) Budgeting is also very useful in "profit planning" - setting targets for profits and related matters and then ensuring accomplishment of targets through analysis of deviations and prompt corrective actions.

(E) Dangers in Budgeting

While advantages of budgeting are quite impressive and far-reaching, certain dangers and limitations of a budgetary program need to be guarded against:

(i) Dangers of over budgeting is one of the serious limitations of budgetary process. Budgets are often so detailed that they become cumbersome, meaningless and unduly expensive. Budgeting may be overdone to the extent that hardly any real authority is left delegated to a number of managers in the organisation. Over-budgeting usually reflects the superior manager's desire to maintain control. However, to derive full benefits of budgetary control, over-budgeting should be avoided and subordinates adequately trained to read and administer budgets in the proper manner.

(ii) Another danger in budgeting is that the department goals may be allowed to supersede the enterprise goals. Individual budgets may not always reflect the enterprise objectives in their proper significance. Similarly, situation may demand that in departmental manager should cross budget limits in the interest of overall business objectives. However, in this enthusiasm and zeal; to keep within budget limits, a departmental manager may overlook the enterprise goals, his primary allegiance to the organisation.

(iii) Budgeting is some used to hide inefficiencies. Budgets tends to grow from the precedent. Budgets continue to carry certain items that have long since ceased to be useful. But the subordinate manager may fail to inform top management about such items because it gives them the opportunity to shift funds and use them for item not allowed higher amounts.

(iv) Budgeting does not yield quick results. It takes time to install and perfect a budgetary programme. In the meanwhile a management expecting too much may soon become impatient and lose interest in budgeting. At the initial stages of its introduction, continuous budgets education is necessary. The budget programme cannot be forced upon people; rather, it must be sold to the people. Those who have to associated with the programme must be properly

guided and trained in the fundamental steps, methods, and purpose of the budgetary control system. The responsible people in the organisation must know it well that a budgetary programme does not manage bur merely serves as a tool to effective management.

(v) There is yet another danger in budgeting arising on account of the problems of inflexibility. Numerical expression of plans developed under a budgetary programme tends to give them a kind of illusive definiteness. Figures are very often taken as final and unalterable. Since budgeting or forecasting is not an exact science, it is conceivable that budgetary plans may become obsolete with shifts in demand, competitions, or internal operating conditions. Thus, figures should be revised when variations from the estimates warrant a change of plans.

(F) Essentials for Success

The following are the essentials for success in budgeting:

(i) Budgets must directly flow from objectives of the enterprise, and goals of budgetary control must be clearly defined

(ii) Budgets should be administered by executive responsible for programme implementation though budget director can greatly assist in the preparation and use of budgets by managers responsible for their implementation.

(iii) Budgets must be prepared for the appropriate period keeping in view the changing complexities, strategies of the business forecast techniques, and the type of budget to be developed. Short-range budgets are usually for a period of upto one year. Cash budgets and revenue and expense budgets are usually of short-term duration. Capital expenditure budget and the research and development budget, on the other hand, are the two important long-term budgets.

(iv) Budgets should be flexible. If actual business conditions differ from what was expected, it should be possible to recast the budgets quickly.

(v) Key or limiting factors must be located. Usually, sales is the limiting factor but in exceptional cases, availability of equipment or raw materials may determine the entire activity.

(vi) Responsible managers should be consulted and associated with budget-making. Wholehearted support of top management to budgeting and its administration is very essential to its success.

(vii) Sufficient time should be allowed for the budget programme to develop and reach nearing perfection.

(viii) Budgeting is greatly helped if there is also system of standard costing in use. One of the aims of budgetary control is to eliminate unnecessary losses or wastages. Unless attention is paid to costs being incurred for each individual product or activity, it would not be possible to keep a proper control over costs.

(ix) Budgetary control must also be supported by a regular, orderly and prompt system of reporting current events and performances so that responsible managers may be kept informed of what is happening in the organisation.

(G) Reporting

The system of budgetary control operates by comparing the actual with the budgeted performance, knowing the difference between the two, ascertaining the exact factors that have led to the difference, and taking appropriate remedial actions. The existence of a discrepancy between the actual and budgeted performance together with factors responsible for it have to be brought to the notice of management so that required action may be taken. This function is performed through proper reporting. Reporting is, therefore, extremely important in a system of budgetary control.

The essence of good reporting is the application of the principle of management by exception. Management does not have unlimited time at its disposal. It has to use the available time very judiciously, it is, therefore, necessary that the time is devoted to those areas or problems which really need attention of management. If management is required to see for itself where attention is required, much of its time will be wasted in that process and problems which need attention may not really get much of it. Reports should be drawn up in such a manner so as to enable the management to realise at a glance where its attention is needed. The whole system should work like the nervous system in the human body where all information about whatever is happening is noted but the mind is burdened only with that information which require some action.

The following points are note-worthy in respect of reports:

(a) The report should be factual and objective. The fancies and ideas of the persons preparing the report must not be allowed to colour the report.

(b) The report should relate to a definite period of activity. It should be prepared in such a way that the responsibilities of various persons and departments are clearly demarcated. A report about a person or a department should not contain information about activities beyond the control of the person of department. For instance, a foreman may not be able to control overhead; therefore, the report about his work should have no reference to overheads.

(c) The report should be brief and concise, but clear.

(d) The report should clearly show what is exceptional or strategic so that management's attention is immediately drawn to it.

(e) Reports which no one uses should immediately be shelved.

(f) A copy of the report should be sent to the person responsible for the activity covered so that he is kept informed about the progress of his work. Report to higher authorities should be summarised.

(g) Above all, the report must be prompt even if it contains the permissible degree of inaccuracy.

(H) Zero Base Budgeting (ZBB)

One of the limitations of traditional budgeting to which attention has been drawn in recent years is that of allocation of financial resources on the basis of historical sharing of funds. Under conventional budgeting the expenditure incurred on an activity in a budget period forms the basis of making estimates for the next budget period. This amount is revised to provide for new activities and expected changes in respect of the current operations. Zero base budgeting is a new approach to budgeting which was first introduced by Peter Pyhrr in 1970 in the United States. It is defined as an operative planning and budgeting process which requires each manager to justify his entire budget in detail from scratch (hence zero-base) and shifts the burden of proof to each manager to justify why he should spend any money at all.

The following steps are implied in zero-base budgeting. First, managers at all levels have to define the objective of each programme of activity that they supervise, and prepare alternative spending plans as `decision packages'. There should be at least three, if not more, such packages: one involving expenditure of (say) 20% below the present level to expenditure or the minimum expenditure which will permit the programme to be continued meaningfully; another package indicating resources in men, materials and money which will be needed to continue the present levels of performance and objectives; and a third package indicating what more could be achieved if additional funds were available to the extent of (say) 10% or more. The executives at the next higher level have then to consolidate these decision packages and rank them in order of priorities.

ZBB as a technique of budgeting based on continuous evaluation of the current activities, provides a convenient reference plan that can be used for controlling activities during the budget period. It is an effective managerial tool to ensure sound planning and efficient budgeting. It can be used more meaningfully in those areas where there exists a direct relationship between the expenditure on an activity and its benefit to the enterprise. However, the process of ZBB involves additional time and effort to be devoted during the initial years.

TRADITIONAL NON-BUDGETARY CONTROL DEVICES

There are many other control devices not connected with budgets. Indeed some of them are related to and used with budgetary control. Important tools in this connection may be referred to analysis of break-even points, internal audit, personal observation, statistical data, etc.

(i) Break-even Analysis

A significant and widely used control technique among the industrial and business enterprises is the analysis of break-even point depicting the relationship of sales and expenses in such a way as to show at what volume revenue exactly covers expenses. Break-even analysis is aimed to project the point of no profit and no loss. At any lesser volume, the organisation would suffer a loss and at a greater volume it would enjoy a profit. The method of calculating break-even point is as follows:

$$\text{Break-even point} = \frac{\text{Fixed Cost}}{\text{Selling Price - Variable Cost}}$$

$$= \frac{\text{Fixed Cost}}{\text{Contribution Margin Per Unit}}$$

The break-even point may also be arrived at with the help of chart.

Break-even analysis is very useful tool in planning and control because it introduces and keeps into account the marginal concept. For instance, break-even analysis pinpoints the effects of additional sales or costs on profits.

(ii) Internal Audit

It is another effective and widely used tool of managerial control. Internal auditing signifies regular and independent appraisal of the accounting, financial, and other operations of a business by a staff of internal auditors.

There is no denying the fact that internal auditors mostly limit themselves to the integrity of accounts and corporate assets. But the horizon of internal auditing can be widened just by bringing under them some more appraisal areas as - policies, procedures, methods, quality of management, etc. But the primary limiting factor in this regard is that no management however broad it may be in outlook and attitude, likes to give these people so much of authority and respond to their queries regarding various aspects of management. Nevertheless, dearth of qualified personnel to carry on such a broad-based audit is also a matter of significance.

(iii) Statistical Data

Managers and executives of the days use various nature of statistical data to analyse and consequently control various facts of their functional areas.

Statistical data collected and compiled are usually presented in the form of charts or graphs which the appropriate persons to visualise the trend and weaknesses in the respective areas of operation and necessarily to adopt the required measure. Charts and diagrams are used by the production, sales, purchase, personnel and even more frequently by the executive heads of companies. In recent years statistical data and information have become the most common means to aid planning and controlling device.

(iv) Personnel Observation

Perhaps the overwhelming significance of personal observation as a tool of control needs no explanation. No matter the nature of control techniques adopted and the tools used, control cannot be effective unless observation is there. Indeed budgets, charts diagrams, statistical data, reports and other devices of control can help to ascertain the result for a definite period or for a comparative analysis, but effective control, above all, calls for personal observation on the part of managers and executives. Of course, the tools mentioned above and the newer and more sophisticated control machineries help visualise the nature of accomplishment. But the problem of control is still one of measuring activities of human beings which necessitates personal attention.

Thus, the main traditional control devices are: Budgetary control, standard costing, financial ratio analysis, internal audit, etc. They are called as traditional because they have used over the years as control techniques.

Non-traditional devices are of relatively recent origin and have brought management control into sharper focus and promise increasingly to improve quality control.

Some of the non-traditional control devices are: Performance budgeting, zero base budgeting, programme planning and budgetary system, responsibility accounting, CPM, PERT, selective quality centre, etc.

Traditional devices focus on non-scientific methods, whereas non-traditional devices are based on more of scientific methods and are more accurate.

CONTROL OF OVERALL PERFORMANCE

Control techniques and systems coming under the purview of management process control are exclusively designed for specific things, e.g., wages and salaries, cash flow, production, product quality, employee training, etc. Evidently, such controls are partial since they apply only to particular areas of enterprise functioning and do not measure total accomplishments against total goals.

As a matter of fact control of aggregate final result or control of overall performance has become an imperative need on the part of enterprises, irrespective of their size and nature. Overall control, in the first place, helps to evaluate and appraise overall functioning of the organisation against the organisation objectives. Secondly, they help to evaluate managers' total effort in an integrated area. In the third place, overall control helps to avoid the chaos of complete autonomy just by bringing the semi-autonomous units under one controlling head. As such, various tools of overall control are widely prevalent and are applied by the enterprises to meet their requirements. Some of the widely practised tools are:

(i) Budget Summaries and Reports

Summary of budgets is a widely used techniques of control of overall performance. The summary being a resume of all individual budgets of the organisation reflects overall plans, identifies shortcomings and deficiencies. Such a summary helps top management visualise the organisation functioning and how the company as a whole is succeeding in its objectives. But such summaries without report are of very limited use for comparing performance with plans. Reports should pinpoint the areas of deficiencies and explain the causes behind.

(ii) Profit and Loss Control

The statement of profit and loss serves a significant control purpose. The statement highlights the constituent parts of a profit or loss for a given period and thus helps viewing the determining factors to success or failure. Managers often use this tool in the form of proforma forecast with a view to controlling and influencing revenues expenses and ultimately the profit.

Companies normally use profit and loss statement for divisional or departmental control since the paper work in building up profits and loss statements for smaller departments or segments of the organisation tends to be too heavy.

(iii) Control through Return on Investment

Return on investment is identified as the ratio of earnings to investment of capital. This technique of measuring absolute and relative success of a company or its units

has received immense attention in recent years. It may be noted in this regard that this tool does not indicate profit as an absolute figure but as a return on capital employed in the business. This tool, evidently, signifies the importance of optimising returns from capital employed and not profit in any way. Because capital is always the critical factor in business and its scarcity limits progress.

However, the return on investment may be measured by the following equation:

$$ROI = \frac{E}{I}$$

where, E = Sales - Cost of Sales

and I = Working Capital + Fixed Capital

Internal and External Auditing Control

Internal audit staff of the companies more often work simply on verifying accounting and financial transactions to supplement the work of the outside auditing firm. But much more may be gained through internal audit if care is taken to locate departure from goals, policies and procedures instead of detecting errors in accounts only.

Auditing of accounts by external firm is to considerable extent an aid to overall management control. External auditing is predominantly a verification of balance sheet items. But the impact of such auditing on overall control cannot be ignored since items having substantial bearing on assets, liabilities and net worth of the companies need to be interpreted, evaluated and considered in proper perspective.

(iv) Control through Key Results

Although the importance of profit as a means of overall control is immense yet the limitations involved cannot be ignored. Since profit as a controlling tool can hardly speak substantially of key areas of the organisations, measurement of performance in some key areas is very much required. It may be noticed that business firms of the day measure results of various key areas to identify performance and thereby give a second thought to policies. Some of the important key areas are:

(a) Profitability: It is felt that rate of return on investment or other profit indices have certain weaknesses in the sense that the incentive for growth is likely to be dampened. As such, two important ratios are employed to measure profitability of companies. These are (i) ratio of gross profit to main income and (ii) ratio of gross profit to capital employed.

(b) Productivity: R.W. Lewis in his book “Planning, Managing and Measuring the Business” viewed productivity as the ability of a business to utilise its human, capital and material resources to the best advantage and the best balance. In other words, productivity signifies and may be measured with the ratio of input to output.

(c) Employee Attitude: Employee attitude is certainly of immense significance in achieving departmental objective and ultimately the mission of the enterprise. Such attitude towards the organisation may be measured by labour turnover, absenteeism, employees’ suggestion for improvement and so forth.

(v) Control through Inter-firm Comparison

Big business and industrial enterprises have of late adopted the practice to effect top planning and control through inter-firm comparison. This technique is immensely helpful in visualising sectoral of area functioning along with the overall functioning of the organisation with a critical land comparative approach.

While applying this technique it is required that comparison must be made between similar business and industry. Nevertheless, whenever required, due weightage should be given to:

(a) age of the firm.
(b) capital employed.
(c) technological development attained.
(d) infrastructure.
(e) tax relaxation.
(f) government subsidy, etc.

to make such comparative analysis really meaningful and worthwhile for the purpose.

(vi) Enterprise Self-audit

The system signifies an appraisal of the enterprise in all its aspects in the light of the present and probable future environment. J.O. McKinsey called this a management audit. This type of audit has been referred to by Billy E. Goetz as "the most comprehensive and powerful of these problem-seeking techniques" "because it seeks overall way to discover and correct errors of management".

The enterprise self-audit helps a company to appraise:

(i) where it is,
(ii) where it is heading under present plans and programmes,
(iii) what its objectives should be,
(iv) whether revised plans and programmes are needed to meet those objectives.

Thus, it may be asserted that self-audit has the distinct advantage of including the top executives of enterprise to evaluate and appreciate overall performance in terms not only of current goals but also of future ones.

NETWORK ANALYSIS

Network analysis is a technique for planning and controlling complex projects and for scheduling the resources required on such products. It achieves this aim by analysing the component parts of a project and assessing the sequential relationships between each event. The results of this analysis are represented diagrammatically as a network of interrelated activities. Broadly speaking, there are two network techniques.

(a) Critical Path Method

Critical Path Method, an important network technique for management control was developed by Walkar of Dupont to reduce time for periodic maintenance. It is used for planning and controlling the most critical activities to accomplish any project. Under this technique a project is broken into different operations or activities and their relationships are determined. These relations are shown with the help of diagram

known as network diagram. The Network diagram or flow plan may be used for optimising the use of resources and time. CPM technique is based on the assumption that activity times are proportional to the magnitude of resources allocated to them and by making a change in the level of resources, the activity times and the project completion time can be varied.

The application of CPM leads to the following advantages:

(i) It provides an analytical approach to the achievement of project objectives which are defined clearly.

(ii) It identifies most critical elements and pays more attention to these activities.

(iii) It assists in avoiding waste of time, energy and money on unimportant activities.

(iv) It provides a standard method for communicating project plans, schedule and cost.

(b) Programme Evaluation and Review Technique (PERT)

PERT is an important technique in the field of project management. It involves basic network technique which includes planning, monitoring and controlling of projects. In addition to its use in schedule planning and control the network concept in PERT provides framework for treating a wide-range of project management problems. Thus, PERT system is directed towards the dynamic management of projects. It specifies techniques and procedures to assist project managers in:

(i) Planning schedules and costs;

(ii) Determining time and cost status;

(iii) Forecasting manpower skill requirements;

(iv) Predicting schedule slippages and cost overruns;

(v) Developing alternate time-cost plans;

(vi) Allocating resources among tasks.

Application of PERT requires that management should know the goal to be achieved, determine the actions necessary to achieve the goal, determine the sequence in which these must performed and carefully establish the time that will elapse at each of the successive stages of actions required to achieve the goals.

PERT uses `probability' and `linear programming' for planning and controlling the activities. Probability helps in estimating the timings of various activities in the project and linear programming is used to maximise the achievement of the project objectives. With the help of these tools, PERT can foretell the probability of achieving the project targets leading to project's main objective.

PERT is employed in construction of ships, buildings and highways, in the planning and launching of new projects, in the publication of books, in the installation and debugging of computer systems. Frequently, PERT systems are used in conjunction with computers. A computer programme is employed that permits calculations to be made without reference to a flow chart or diagram.

MANAGEMENT AUDIT

Companies get their accounts audited at least once a year. This statutory audit is intended to ensure that the company's records and reports reflect sound

accounting principles. Such an audit looks to the past, to historical records of past performance. However, some of the progressive companies appear to have recognised the importance and utility of management audits. And management audits are becoming increasingly significant in connection with control of overall performance of the enterprise and its management.

Management audit may be defined as the systematic and dispassionate examination, analysis and appraisal of management's overall performance. It is basically a procedure or a form of appraisal of management's total performance by means of an objective and comprehensive examination of the organisation structure or its components, such as a department, its plans and policies, methods of operation, controls and its use of physical facilities and human resource. Thus, management audit signifies critical assessment of management of the enterprise from the broadest possible point of view. Such an audit may be undertaken by the management itself, or it may be carried out with the help of management consultants. In the same way, while a comprehensive management audit may be recommended, companies may even apply it independently to some specific sections of the organisation. Thus, production efficiency or investment appraisal may well be the subject matter of management audit. It may even be used to provide guidance on critical assessment of capital budgeting or profit performance.

(A) Financial Audit and Management Audit

Management audit should not be confused with accounting or statutory audit. Accounting audit is concerned with verification and confirmation of financial data, and is essentially historical in character. But management audit looks to the past, the present and the future. Its basic purpose is to appraise the management performance of the departments and the company on the whole. In terms of scope, financial audit is largely concerned with financial records and results of company's operation for the year, while management audit goes further and covers areas of management on asset potential, capacity utilisation, executive evaluation, personnel practices, physical facilities, financial procedures, and others not directly covered by the former. Rights and duties of company auditors are well defined in the statute governing them, and are also governed by judicial pronouncements. So far as management audit is concerned, there are no clearly defined rights and duties of such an auditor; nor is there any uniformity in the depth of the audit. Statutory audit is conducted by an independent qualified auditor but management audit may even be undertaken by management itself; the qualifications of those conducting management audit are not prescribed by any law.

(B) Scope of Management Audit

Management audit was originally developed as a tool for investment appraisal. However, since management process is the same in all organised cooperation, business or social, the concept has gradually been extended to cover virtually all kinds and sizes of organisations, and principles of management audit remain valid irrespective of the nature of the enterprise. It now covers all aspects of the business-economic, physical tangible, quantitative, financial and personnel.

However, it should be clear that management audit is a measure of control designed to improve performance, eliminate inefficiencies and increase effectivity and profits.

Management audit is now increasingly used to evaluate management's objectives, the extent to which they have been achieved and company policies and procedures complied with. On this basis, some people argue that objectives are determined by management and that management audit is only to report the extent to which objectives are attained. However, it can well be argued that the jurisdiction of management audit needs be extended further with the right and responsibility to pass judgment on objectives too, because if objectives are ill-founded, results and their variances are likely to be misleading. Techniques of responsibility accounting combined with accounting manual and classification can be used to even disclose personnel contribution of the people involved.

(C) Appraisal Areas

Management audit consists of two distinct parts-systematic compilation of relevant data and its analysis with a view to appraising management's overall performance.

The American Institute of Management has identified ten categories of appraisal areas to be used under any comprehensive management audit programme.

(1) Economic Function

This category includes appraising public value of the company in relation to different interest like consumers, shareholders, employees, suppliers and the communities in which it operates.

(2) Corporate Structure

Under this category is appraised the effectiveness of the corporate structure through which the management seeks to accomplish its objectives.

(3) Health of Earnings

It is concerned with determining the income itself and also appraising the extent to which profit potential of the company's asset has been realised.

(4) Service of Shareholders

Here, the management audit team determines the company's service to the shareholders. This is mainly done on three basis:

(i) minimisation of risks to investment,

(ii) reasonable return on investment, and

(iii) reasonable capital appreciation over a period of time.

(5) Research and Development

For giant companies particularly, evaluation of its research policies is crucial to management audit. Research and development success is evaluated in terms of the part played by it in the company's past progress and also in terms of how successfully research policies are preparing the company for future progress and improvement of its industry position.

(6) Directorate Analysis

In this appraisal area three elements usually considered are –

(i) the quality of each director and his contribution to the board.

(ii) the extent to which directors work as a team.

(iii) whether the directors act as trustees for the organisation.

Fiscal Policies

The key factors under this category of appraisal are providing, controlling and managing thriftily the use of funds. Thus, the management audit team has to study and appraise company's capital structure, organisation for developing fiscal policies and controls, their application in different areas of corporate activity

(8) Production Efficiency

Production or operating efficiency is equally vital to manufacturing as well as non-manufacturing companies. The first part under this category which is frequently over-emphasised, is the appraisal of machines and materials management. An equally important part in appraising production efficiency is the evaluation of `manpower management,' i.e., management of non-executive employees. Each of the two aspects should be duly considered while appraising production efficiency.

(9) Sales Vigour

There are significant variations in sales practices and marketing principles followed by different companies even in the same industry. Still, sales vigour can be evaluated if marketing goals are properly determined. The extent to which past sales potential has been realised, development of sales personnel, and the extent to which present sales policies of the company will enable its management to realise future sales potential, are the three important bases than can be used to appraise the sales vigour.

(10) Executive Evaluation

Each of the appraisal categories discussed above to some extent involve evaluation of the concerned executives. However, because of their vital role, the quality of executives and their management philosophy need to be evaluated separately. The American Institute of Management has found three personal qualities as being essential elements for business leaders. These are ability, industry and integrity. Good management demands that executives should work, together in harmony, and ensures company's continuity by sound policies, decisions, procedures and programmes relating to different activities of the enterprise.

(D) Management Self-audit

Some authorities advocate a periodic management self-audit so that management errors are discovered and corrected. This calls for knowing the present position of the enterprise and also determining the direction and destination towards which the enterprise is marching forward. No enterprise exists in complete isolation, and as such its future direction should be determined in the light of the appraisal and the outlook for the industry as a whole. Since efficiency and performance of the company is largely dependent upon the organisation structure and its personnel, management self-audit should lay sufficient stress on both these aspects. Policies, personnel, physical facilities, and financial resources are the other important areas to which self-appraisal must extend.

However, because of their preoccupation with operational aspect of the enterprise, management may lack sufficient time and aptitude to perform management audit by themselves. Proximity to the situation, personal interests and considerations, conflicts and group policies are some of the additional factors that may require the management to give up management self-audit in favour of management audit by outside experts.

(E) Management Audit by Consultants

Management consultants render different kinds of services to the company management. Management audit is one such area where their services are available. With the passage of time, the demand for this kind of service is likely to increase substantially. Like certified public accountants, the management consultants study the business as a whole and in respect to all its departments. Business policies, procedures, organisation structure, operating methods financial controls, personnel practices, physical facilities, and management performance, all are systematically examined and appraised in a very dispassionate manner. Management audit by consultants are performed with the object of helping the management to improve the position of the company. Because of their experience, training and skill in the techniques of analysis and research, management consultants are in a better position to diagnose the present state of health of the organisation and recommend improvements for its added prosperity.

Appraising quality of company's managers and its managerial philosophy, though very essential and important for its long-term success, is not an easy task. However, as the time goes by and with increase in the knowledge and skill in this field, management audit is likely to become a routine affair like the financial audit by independent certified public accountants. Management audit by an outside firm with properly qualified and skilled staff to effectively appraise management overall performance is therefore, an interesting future possibility.

Total Quality Management (TQM)

Success of any organisation depends on offering quality products at competitive prices. All over the world, it is being realised that quality control be ensured through inspection and test alone. Every department and individual has a contribution to make in achievement of quality.

Quality can be the most significant factor in determining the long-run success or failure of any organisation. High quality of products can give a competitive edge to an organisation. On the other hand good quality generates satisfied customers who reward the organisation with continued patronage and favourable word of mouth advertising.

TQM owes its genesis to post war research of American management consultants like Drs. Joseph Juran and W. Edwards Dening who introduced statistical control techniques to the Japanese during Japan's rebuilding period. Prior to the Word War II, the Bell Telephone system was the leader in the early modern history of quality control. In the Western Electric Company an inspection department was created to support the Bell Operating companies in the early 1990s. Quality assurance was applied to design manufacturing and installation. During the World

War II, the US military began using statistical sampling procedures and imposing strict standards on suppliers. Thus, statistical quality control became widely known and gradually adopted by other industries.

Growth in consumer quality awareness has put a greater strain on business. Consumer demands and dynamic technological changes have opened up new and highly competitive markets. The quality of goods and services can no longer be taken for granted. The rapid growth of the service sector has also introduced new perceptions for quality management. Institutions such as the Government, banks and hospitals do not produce tangible goods. The interaction between employees and customers is much more critical in such organisations. As a result, the skills, attitudes and training of service personnel affect the quality of the service delivered. Information processing represents a large component of the work done by service organisations and poses special quality considerations. Errors in computer billing or airline and hotel reservations are the result of poor quality control of computer software and data input systems.

In view of globalisation of markets, Governments have begun to realise that quality is essential to international trade and the national economy, public purchasing authorities have been instructed to buy goods that confirm the quality standards. Some time back, the European Economic Community collectively established a common set of quality standards known as ISO 9000. While ISO 9000-ISO 9003 series is a reference for external quality assurance, ISO 9004 is for internal quality management. Taken together these standards aim at achieving TQM.

The lesson is that quality must not be viewed solely from a technical point of view; a significant emphasis must be placed on managerial activities. We view the total quality system as composed of two related systems-the *management system* and the *technical system* (see Figure 1). The management system is concerned with planning, organising, controlling, and human resources management processes relating to quality assurance programs. Growing out of human resources management are structures for employee involvement and team approaches to decision making, quality improvement, and problem solving.

The important terms in this global view of quality are *system, process, structure, and technique.* A system, as we use it here, is the interrelated set of plans, policies, processes, procedures, people, and technology required to meet the objectives of an organisation. A process consists of policies, procedures, steps, technology, and personnel needed to carry out a significant segment of operations within an organisation. Usually, a process will cross several organisational boundaries within an operating unit and require coordination across those boundaries. A structure is a formal or informal organisational entity that is developed to perform a certain process or set of tasks. A technique is a systematic approach, procedure, and associated technology required to carry out a task.

Management must be aware of customer needs, the capability of the company's production processes, and the financial implications of any decision; in short, management must know how all the components in the organisation tie together.

Quality is the responsibility of everyone in the organisation, from the operators on

the production floor to the chief executive officer. People such as machine operators, assembly line workers, ticket agents, nurses, and waitresses are the craftspeople who build quality into products and services. First-line supervisors must provide the

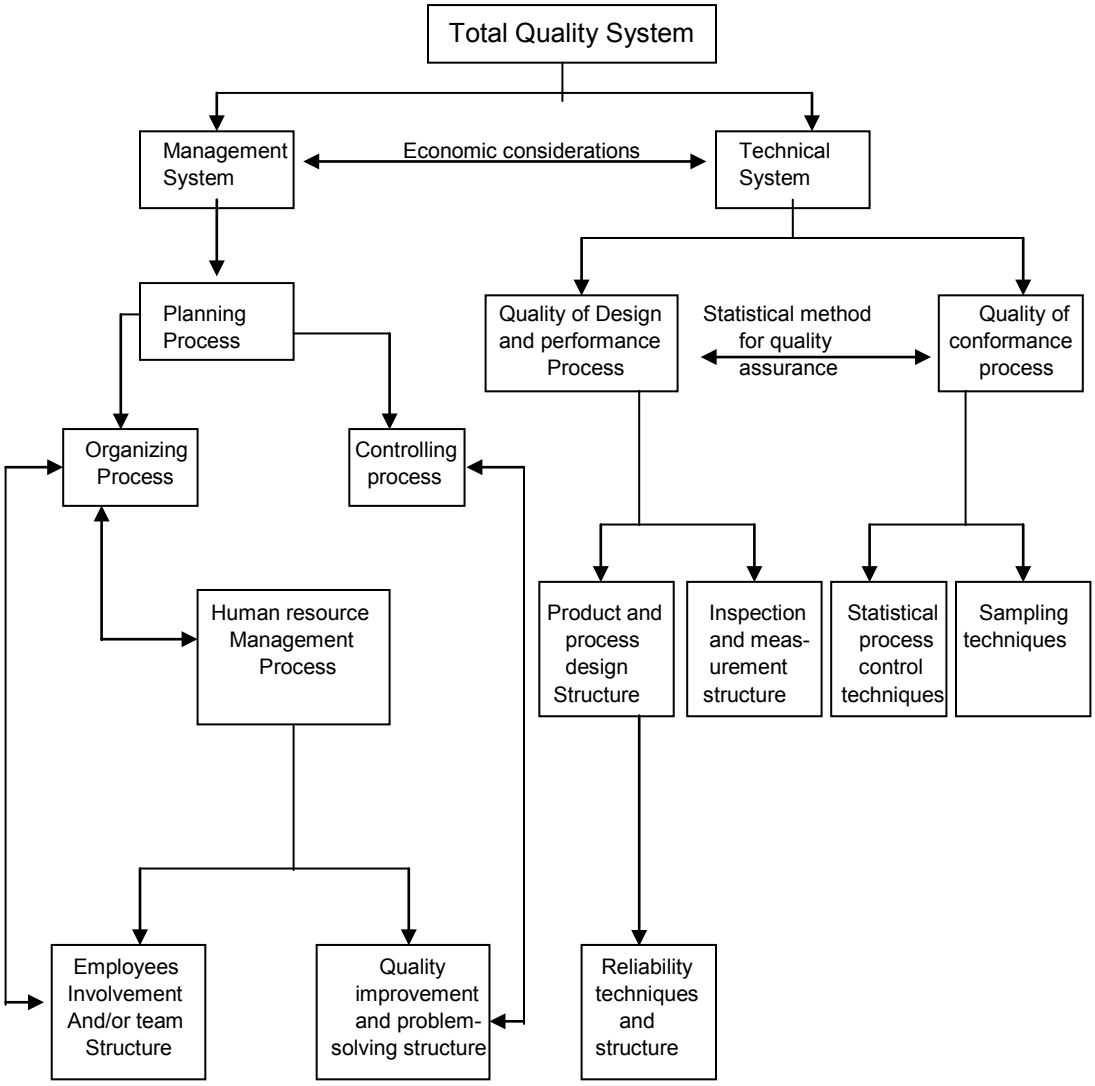


Figure 1: The Total Quality System Model

motivating climate for employees, direct them in proper procedures, work together with them to locate problems, and assist in eliminating sources of error. Middle management must plan, coordinate, execute, and monitor quality policy. Finally, top management must commit the resources and provide the leadership necessary to set the tone and carry out the requirements of an ongoing dynamic quality policy.

The technical system involves the assurance of quality in product design, the planning and design of manufacturing or service- producing processes, and the control of incoming materials, intermediate production and finished goods. These are included in the "Quality of Design and Performance Process" block of Figure 1. To ensure conformance to the requirements of the process or service, the "Quality of Conformance Process" must be developed. Statistical process control techniques and sampling techniques are usually employed in each of these areas for the identification of quality problems and for controlling the quality of production processes. Both the design and performance process the conformance process must be coordinated and work together. Information transfer between the two systems is necessary for effective problem solving and quality improvement.

Economic considerations and total quality management play a crucial role in tying together the management and technical systems: New technologies such as on-line process control, automatic gaging, and new analytical tools also present new opportunities to both management and technical personnel for quality assurance.

SELF-TEST QUESTIONS

1. Define the concept of managerial control. Discuss the nature of control.
2. Discuss the requirements of an effective control system.
3. "Planning is an empty exercise without control". Comment.
4. Define budgetary control system. What are the essentials effective budgetary system?
5. Define budget. What are the different types of budgets used in business?
6. What are the non-budgetary control techniques? Discuss any one of them in detail.
7. Discuss the advantages and limitations of budgetary control.
8. Define management audit. Discuss the appraisal areas that should occupy the attention of management audit team. How does management audit differ from financial audit?
9. What factors have contributed to the increased awareness of quality in modern business?
10. The emphasis has shifted from statistical quality control to Total Quality Management. Discuss.
11. Write short notes on:
    (i) Zero base budgeting.
    (ii) Project Evaluation and Review Technique.

(iii) Total Quality Management.

(iv) Critical Path Method.

(v) Traditional and Non-traditional Control Devices.

(vi) Management Self Audit.

(vii) Non-traditional Devices of Control.

Suggested Readings:

(1) Professional Management — *Haimann*

(2) Essentials of Management — *Koontz & O'Donnell*

(3) Business Budgeting and Control — *Heckert (J.B.) and Wilson (J.D.)*

(4) Business Policy — A Management Audit Approach — *William T. Greenwood*

STUDY XVIII

SOCIAL RESPONSIBILITY OF BUSINESS

Introduction

In common parlance, social responsibility is a doctrine that claims that an entity whether it is State, government, corporation, organization or individual has a responsibility to society. Among these entities activist groups and local communities can also be associated with social responsibility. Social responsibility means eliminating corrupt, irresponsible or unethical behaviour that might bring harm to the community, its people, or the environment before the behaviour happens.

Organizational survival is dependent upon a series of exchanges between the organization and its environment. These exchange and continual interaction with the environment give rise to a number of broader responsibilities to society in general. The broader responsibilities, which are both internal and external to the organization, are usually referred to as social responsibilities. These social responsibilities arise from the independence of organizations, society and the environment.

Over the last 50 years, one of the most revolutionary changes in capitalism has been the development of 'conscience.' Private business, which is the hard core of this economic system, has realized and has been made to realize by several social, economic and political forces, that it has social obligations to fulfill, besides ensuring its own existence through profitable activity. It is be pertinent to know some of the forces and factors which have persuaded businessmen to consider their responsibilities and the conditions which were favourable to the development of businessmen's concern with social responsibilities. Some of the more important among them are:

- The threat of public regulation of private ownership.
- The pressure of the labour movement.
- The development of moral values and social standards applicable to businessmen.
- The development of business education and contacts with the government and its problems. Recognition of human factors contributing to the long-term interests of business.
- The development of a professional managerial class with different motivation and point of view due to the separation of ownership from management in the corporate enterprise.
- The increased complexity of the decision-making processes in which many persons participate and in which various points of view and diverse interests are expressed.
- The change in public opinion about the role of business in modern society.

These and a number of other social, ethical and economic forces have combined together to make business a socio-economic activity. Business is no longer a mere occupation, it is an economic institution operating, in social environment, an institution that has to reconcile its short-term and long term economic interests with the demands of the society in which it functions. Essentially, it is this which gives rise to the general and specific social responsibilities of business.

While traditional business models primarily emphasize the economic aspects of

organizational activity (e.g. profitability and growth), more modern conceptions of organizational behaviour lay equal stress on social, ethical and environmental impacts as exemplified by the notion of “corporate social responsibility”.

Social responsibility is voluntary; it is about going above and beyond what is called for by the law (legal responsibility). It involves an idea that it is better to be proactive toward a problem rather than reactive to a problem. It would be fair to say that while some business organizations remain to be convinced that social responsibility is compatible with value creation, a growing number accept that they can and should manage their social and environmental impacts in ways which benefit both the organization and the wider society.

Before dwelling with the social responsibilities of business organizations, it is pertinent to discuss the business and its environment.

Concept of Business

The term *business* is derived from the word *busy.* Thus, business means being busy. However, in a specific sense, business refers to any occupation in which people regularly engage in activities with a view to earning profit. The activity may consist of production or purchase of goods for sale, or exchange of goods or supply of services to satisfy the needs of other people. Since the main objective of business is to earn income or profit through business dealings, it is an economic activity. Business may thus, be defined as “any economic activity on a continuous basis which involves production or purchase of goods for sale, transfer or exchange of goods, or supply of services, at a profit”.

Business and its Environment

The environment in which an individual or an organization operates has more or less a direct bearing on his or its objectives and functions; this applies to business organization as well as it does to any other type of organisation. A proper estimate of the objectives of business can, therefore, be made only after an understanding of the environment in which a business firm functions. The environment of a business enterprise comprises of several segments which may be classified as under:

Social: Comprising consumers and employees as well as social institutions which benefit from business or provide benefits to it.

Economic: Encompassing the whole economy, the various economic institutions including other firms with which an enterprise has to deal.

Political: Covering the political institutions of the country, including the government and the legislature, which regulate business activity and draw upon the resources of business firms in the form of taxes of different kinds?

Technological: Comprising the know-how and production and management technology available to business firms at any point or period of time.

The relationship between a firm and its environment is one of mutual benefit. This is referred to as a 'symbiotic' relationship. The word symbiosis is taken from Botany and refers to the mutually beneficial relationship that exists between the trees and the small plants. Just as tree draws food and nutrition from small plants growing underneath and the plants get their food from the tree and its leaves, the business firm has also to function in such a way that it takes from and gives nutrition to, the

various segments of its environment. Only through such a relationship can a business firm survive and prosper. Otherwise, it will starve and wither away.

Another way of describing the environment of a firm will be to take stock of the various interest groups which are contributors to the firm's continuity and prosperity and also claimants of return in different forms from the business firms. These groups include consumers, employees, stock holders, creditors, suppliers, distributors, competitors and the government. The survival and growth of a business firm will depend upon its relations with all these interest groups. The above segment shows free-firm in relation to the different interest groups that constitute its environment.

Objectives of Business

Since the environment of a business firm comprises several interest groups, it must have a multiplicity of objectives instead of a single objective, profit, which has been traditionally overemphasised. Peter F Drucker says, “To manage a business is to balance a variety of needs and goals," Therefore, he declares: "Objectives are needed in every area where performance and results directly and vitally affect the survival and prosperity of the business. There are eight areas in which objectives of performance and results have to be set: Market standing, innovation, productivity, physical and financial resources, profitability, managers' performance and development, workers' performance and attitude and public responsibility".

Market standing: Business activity can be sustained only if it has any standing in the market. For market standing it is not enough for the business to fulfill the purpose of creating a customer. The business has to be more specific and analyse the market and find out where it stands. The market consists of customers as well as competitors. To measure market standing two things have to be taken into consideration — market potential and competition. The business has to determine in quantifiable terms the present and prospective customers and what share of the market it has been able to capture. Accordingly an objective has to be set for sales figures, the size of the market and the share in the market. The business also has to see itself in the light of competition. Sales may be increasing every year but competing products may have a larger share of the market and may have new and improved features. Therefore, the strength of a competitor must never be underestimated. The objective, of a business must therefore be to establish a place in the market and protect itself from competition.

Innovation: The next objective of a business enterprise is innovation or inventiveness. To innovate means to explore and discover ways and means of making products more useful. It also includes improving methods of production, exploring new markets, and use of better methods of distribution. Business can flourish only if the economy is dynamic and is always on the move. This can happen only if every branch of business is on the alert and tries to discover ways and means of improving, changing and enriching the entire operation. Innovation may be of two kinds:

(a) Innovation in product or service; and

(b) Innovation in the various skills and techniques needed to supply them. A business enterprise that stops innovating slows down, stagnates and is left behind in the race of competition.

Productivity: Another important objective of a business is productivity. In its attempt to secure perpetual existence and prosperity, a business firm can succeed

only if it is conscious of the need to make the best use of available resources and secure the maximum return with the minimum of input. This calls for a will to do better on the part of management and the operative personnel.

Physical and Financial Resources: Yet another important objective of a business is to secure adequate physical and financial resources to be able to supply the goods and services and value satisfaction desired by the customers. Management has the responsibility for planning and acquiring the physical facilities and other resources needed to turn the wheels of production. The maintenance of sufficient assets and resources is, of course, a part of this objective.

Profitability: Profitability is still another objective that a business firm must strive to attain. Profit in relation to capital investment is not only a good measure of the net effectiveness and soundness of a business effort but it also serves the purpose of covering costs like replacement, obsolescence, market risk and uncertainty and is necessary to ensure the supply of future capital for innovation and expansion. A business must have enough profit to advise the market rate of return on existing investment and to produce the additional capital needed.

Apart from the above mentioned objectives, a business enterprise has also to make conscious attempts for the development of its human resources by keeping a vigilant eye on its managers' and workers' performance and their development. This is important because the human factor activates other resources and, as such, it holds the key to the performance of the enterprise in other areas.

Last, but surely not the least, is the question of public or social responsibility of a business enterprise. This is an objective which cannot be stated in as tangible terms as others and yet recent developments in our economy as well as others bring out its crucial importance. We shall discuss the specific responsibilities under this head later.

Concept of Social Responsibility

The concept of social responsibility received increasing attention during 1960’s because of the need for corporations to respond to the changing social environment of business. This change was often described as a change in terms of the understanding between business and society that reflected changing expectations regarding the social performance of business. The old understanding between business and society was based on the view that economic growth was the source of all progress, social as well as economic. The engine providing this economic growth was considered to be the drive for profits by competitive private enterprise. The basic mission of business was Thus, to produce goods and services at a profit, and in doing this business was making its maximum contribution to society, and in fact, being socially responsible.

The concept of social responsibility is fundamentally an ethical concept. It involves changing notions of human welfare and emphasises a concern about the social dimensions of business activity that have a direct connection with quality of life in society. The concept provides a way for business to concern itself with these social dimensions and pay some attention to its social impacts.

The word responsibility implies that business organisations have some kind of obligation toward the society in which they function to deal with social problems and

contribute more than just economic goods and services. Business is no longer a mere occupation, it is an economic institution operating, in social environment, an institution that has to reconcile its short-term and long term economic interests with the demands of the society in which it functions. Essentially, it is this which gives rise to the general and specific social responsibilities of business.

What Social Responsibility of Business Means

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

Social responsibility means obligations of the businesspersons to pursue those policies that help society in achieving its objectives and values. This is an objective which cannot be stated in as tangible terms as others and yet recent developments in our economy as well as others bring out its crucial importance.

In the classical view, a business was acting in a socially responsible fashion if it strived to utilize as efficiently as possible the resources at its disposal in meeting the goods and services that society wanted at prices consumers were willing to pay. If this were done well, said classical economic theory, businessmen would maximize profits. The concept of socially responsible action has been broadened today far beyond this boundary, but there is no consensus on either a definition or the limits of action.

Conceptual social responsibilities refer to “the businessman’s decisions and actions taken for reasons at least partially beyond the firm’s direct economic or technical interest”, (Davis, 1960 : 70). A somewhat broader view says they are obligations to “pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society”.

Even a wider dimension is given by the Andrews as follows:

By “social responsibility” we mean the intelligent and objective concern for the welfare of society that restrains individual and corporate behaviour from ultimately destructive activities, no matter how immediately profitable, and leads in the direction of positive contributions to human betterment, variously as the latter may be defined.

Fundamentally, these definitions say that actions taken by a business which in some degree helps society to achieve one or more of its objectives are socially responsible actions.

Other Definitions

Social responsibility refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action, which are desirable in terms of the objectives and values of our society. *(Howard R. Bowen)*

Social responsibility is to create maximum shareholder value working under the circumstances where it is fair to all its stakeholders, workers, consumers, the

community, government, and the environment. *(Narayana Murthy)*

The idea of social responsibilities supposes that the corporation has not only economic and legal obligations but also certain responsibilities to society, which extend beyond these obligations. *(Joseph W. McGuire)*

Corporate social responsibility relates primarily to achieving outcomes from organisational decisions concerning specific issues or problems, which (by some normative standard) have beneficial rather than adverse effects upon pertinent corporate stakeholders. The normative correctness of the products of corporate action has been the main focus of corporate social responsibility. *(Edwin M. Epstein)*

Why Should Business be Socially Responsible?

As stated earlier, social responsibility is a voluntary effort on the part of business to take various steps to satisfy the expectation of the different interest groups. The interest groups may be owners, investors, employees, consumers, government and society or community. But the question arises, why should the business come forward and be responsible towards these interest groups. Let us consider the following points:

(i) *Public Image:* The activities of business towards the welfare of the society earn goodwill and reputation for the business. The earnings of business also depend upon the public image of its activities. People prefer to buy products of a company that engages itself in various social welfare programmes. Again, good public image also attracts honest and competent employees to work with such employers.

(ii) *Government Regulation:* To avoid government regulations businessmen should discharge their duties voluntarily. For example, if any business firm pollutes the environment it will naturally come under strict government regulation, which may ultimately force the firm to close down its business. Instead, the business firm should engage itself in maintaining a pollution free environment.

(iii) *Survival and Growth:* Every business is a part of the society. So for its survival and growth, support from the society is very much essential. Business utilizes the available resources like power, water, land, roads, etc. of the society. So it should be the responsibility of every business to spend a part of its profit for the welfare of the society.

(iv) *Employee satisfaction:* Besides getting good salary and working in a healthy atmosphere, employees also expect other facilities like proper accommodation, transportation, education and training. The employers should try to fulfill all the expectation of the employees because employee satisfaction is directly related to productivity and it is also required for the long-term prosperity of the organisation. For example, if business spends money on training of the employees, it will have more efficient people to work and thus, earn more profit.

(v) *Consumer Awareness:* Now-a-days consumers have become very conscious about their rights. They protest against the supply of inferior and harmful products by forming different groups. This has made it obligatory for the business to protect the interest of the consumers by providing quality products at the most competitive price.

These and a number of other social, ethical and economic forces have combined together to make business a socio-economic activity. Business is no longer a mere occupation, it is an economic institution operating, in social environment, an institution that has to reconcile its short-term and long term economic interests with the demands of the society in which it functions. Essentially, it is this which gives rise to the general and specific social responsibilities of business.

Social Responsibilities of a Business

Even though corporate responsibility for increasing the wealth of owners (Shareholders) is well recognised, other social responsibilities are only beginning to be accepted. A brief list of the many areas is given here in which corporations have acknowledged their social responsibility and established programmes to deal with them.

(i) *Consumers:* A business enterprise has the responsibility of providing the goods and other services needed by the community at the most reasonable possible prices. It must guard against adulteration, poor quality, lack of service and courtesy to customers, misleading and dishonest advertising, etc. The consumers also need protection against monopoly and restrictive trade practices. Such protection can be provided best if business learns to play its part with fairness and liberalism.

(ii) *Natural environment:* Responsibility for protecting the natural environment includes judicious use of natural resources, energy conservation, abatement of polluting emissions, and waste management.

(iii) *Employees:* Responsibility toward employee welfare includes providing fair compensation and benefits and safe work environment, eliminating discrimination, providing opportunities for personal and professional development, and having progressive human resource policies.

(iv) *Government agencies:* Responsibilities toward local, state and central government agencies include fulfilling obligations under regulations and statutes of these agencies, cooperating in planning and investigations, and coordinating administrative activities with these agencies.

(v) *Community:* Responsibilities to the public or communities where the corporation has operations include providing economic stability, safeguarding public safety, protecting the environment, and aiding in the development of social and cultural resources of the community through corporate philanthropy.

(vi) *Media:* Responsibilities toward the media include being cooperative and truthful about issues that affect public welfare.

For your information, a number of Indian companies discharge their social responsibilities quite satisfactorily. There are many companies, which have excelled in such activities but when seen in the light of the country's vast needs, the achievements fall short of requirements. The money spent for social causes by companies is generally, an insignificant proportion of their turnover. Following are few illustrations of such socially responsible Indian companies:

— TISCO has been a pioneer in discharging social responsibility and has made several contributions in areas such as community development, social

welfare, tribal area development, agriculture and related activities, rural industrialisation, etc.

— Asian Paints funded a large scale community development project to enable farmers to use local resources effectively.

— SAIL contributes to the sectors of agriculture, industry, education, health care, dairy, poultry, fisheries and drinking water supply.

— ITC is socially active in the areas of agriculture, culture, sports and music.

— BHEL has contributed to the development of the quality of life in rural areas, health care and family welfare, adult-education, etc.

— Brooke Bond has been interested in animal welfare, providing veterinary service, and improvements in animal breeding.

— Colgate Palmolive did pioneering work in the promotion of sports, dental health, and small industry development.

Conclusion

The first responsibility to society is to operate at a profit, and only slightly less important is the necessity for growth. The business is the wealth-creating and wealth-producing organ of the society. Management must maintain its wealth-producing resource intact by making adequate profits to offset the risk of economic activity. And it must beside increase the wealth-producing capacity of these resources and with them the wealth of society.

Ethics play an important role in social responsibility. The business organizations must have ethical responsibility as they are doing business, including production, management, and services and so on. Without ethics, it would be danger to the human. Ethics is simply the rules that say what is right and wrong, as defined by a particular reference group or individual.

The social responsibility is very important to both society and business organizations. Although there are some arguments for and against social responsibility, even more of the organizations would take action on social responsibility. Many of the advantages being social responsibility was created, some of that was already discuss on previous pages. Believed that, the best interest of business organizations is social responsibilities, that would be benefit in the long run of company, can be earn more profit, and benefit to the human and the environment.

SELF-TEST QUESTIONS

1. What does social responsibility of business mean? Why should business be socially responsible?
2. Identify the areas in which objectives of performance and results of the business have to be set.
3. Explain the concept of social responsibility of business. Is social responsibility a compulsion?
4. Elucidate the factors that have persuaded businessmen to consider their responsibilities and the conditions which were favourable to the

development of businessmen's concern with social responsibilities.

5. Enumerate the areas in which corporations have acknowledged their social responsibility and established programmes to deal with them.

Suggested Readings:

(1) Business Environment: *Raj Agrawal & Parag Diwan*

(2) Business Studies: *NCERT*

(3) Social Responsibility: *vinsign.com*

APPENDIX

GLOSSARY OF LEGAL TERMS/MAXIMS

Sometimes students write to us about their difficulty in understanding the meaning of legal terms, phrases and maxims generally used in discussions relating to legal matters and in particular used in the various study lessons relating to different laws. In order to help such students, we are giving hereunder some of the important legal terms and maxims.

A priori: From the antecedent to the consequent.

Ab initio: From the beginning.

Absoluta sententia expositore non indiget: Plain words require no explanation.

Actio mixta: Mixed action.

Actio personalis moritur cum persona: A personal right of action dies with the person.

Actionable per se: The very act is punishable and no proof of damage is required.

Actus Curiae Neminem Gravabit: Act of the Court shall prejudice no one.

Actus non facit reum, nisi mens sit rea: An act does not make a man guilty unless there be guilty intention.

Actus reus: Wrongful act.

Ad hoc: For the particular end or case at hand.

Ad idem: At the same point.

Ad valorem: According to the value.

Aliunde: From another source.

Amicus Curiae: A friend of court member of the bar who is appointed to assist the Court.

Animus possidendi: Intention to possess Audi alteram partem: Hear the other side.

Benami: Nameless.

Bona fide: In good faith, genuine.

Caveat: A caution registered with the public court to indicate to the officials that they are not to act in the matter mentioned in the caveat without first giving notice to the caveator.

Caveat actor: Let the doer beware.

Caveat emptor: Let the buyer beware.

Caveat venditor: Let the seller beware.

Certiorari: A writ by which records of proceeding are removed from inferior courts to High Court and to quash decision that goes beyond its jurisdiction.

Cestui que trust: The person who has the equitable right to property in India he is known as beneficiaries.

Consensus ad idem: Agreement as to the same thing. The common consent necessary for a binding contract.

Contemporanea expositio est optima et fortissima in lege: The best way to construe a document is to read it as it would have read when made.

Corpus delicti: The facts that constitute an offence.

Cy pres: As nearly as may be practicable/possible.

Damnum sine injuria: Damage without injury.

De facto: In fact.

De jure: By right (opposed to de facto) in Law

Dehors: Outside, foreign to (French term).

De novo: To make something anew.

Dies non: Day on which no legal business is transacted. e.g. bank holiday, National holiday.

Deceit: Anything intended to mislead another.

Del credre agent: is a mercantile agent who in consideration of extra remuneration called a del credre commission undertakes to indemnify his employer against loss arising from the failure of persons with whom he contracts to carry out their contracts.

Delegatus non potest delegare: A delegate cannot delegate.

Dictum: Statement of law made by judge in the course of the decision but not necessary to the decision itself.

Dispono: Convey legally.

Ejusdem generis: Of the same kind or nature. Where there are general words following particular and specific words, the general words must be confined to things of the same kind as those specified.

Estoppel: Stopped from denying.

Ex parte: Proceedings in the absence of the other party.

Expressio unius est exclusio alterius: Express mention of one thing implies the exclusion of another.

Ex turpi causa non oritur actio: No action arises from an illegal or immoral cause.

Fatum: Beyond human foresight.

Fait accompli: Things done and no longer worth arguing against; an accomplished act.

Factum probanda: Fact in issue which is to be proved.

Factum probans: Relevant fact.

Ferae naturae: Dangerous by nature; of a wild nature.

Force majeure: Circumstance beyond one's control, irresistible force or com pulsion.

Generalia specialibus non derogant: General things do not derogate from special things.

Habeas corpus: A writ to have the body to be brought up before the judge.

Ignorantia legis neminem excusat: Ignorance of law excuses no one.

Injuria sine damno: Injury without damage.

Interest reipublicae ut sit finis litium: State or public interest requires that there should be a limit to litigation.

Ipso facto: By the very nature of the case; by the mere fact.

In promptu: In readiness.

In posse: In a state of possibility.

In limine: Initial stage; at the outset.
In lieu of: Instead of.
Inter alia: Among other things.
Inter se: Among themselves.
In specie: In kind.
Inter vivos: Between living persons.

Intra vires: Within the powers.

In personam: A proceeding in which relief is sought against a specific person.

Indicia: A symbol; token; mark.

Innuendo: An allusive remark.

Jus in personam: Right against a specific person.

Jus in rem: Right against the world at large.

Jus non scriptum: Unwritten law; Customary Law.

Jus scriptum: Written Law.

Lex Mercatoria: The law merchant. It is a body of legal principles founded on the customs of merchants in their dealings with each other, and though at first distinct from the common law, afterwards became incorporated into it.

Lex fori: The law of the forum or court.

Lis: A suit or legal action.

Lis pendens: A pending suit.

Locus standi: Right of a party to an action to appear and be heard on the question before any tribunal.
Mala fide: In bad faith.

Mandamus: We command. A writ of command issued by a Higher Court to a Lower Court/Government/Public Authority, to compel the performance of a public duty.

Mens rea: Guilty mind.

Mansuetae naturae: Harmless or tame by nature.

Mesne profits: The rents and profits which a trespasser has received/made during his occupation of premises, which are lost to the actual owner.
Misnormer: A wrong or inaccurate name or term.

Mutatis but mutandis: With necessary changes in points of detail being made.

Noscitur a sociis: The meaning of a word can be gathered from the context; a word is known by its associated words.

Obiter dictum: A saying by the way. An incidental opinion by a judge which is not binding.

Onus Probandi: Burden of proof.

Pari passu: On equal footing or proportionately.

Per se: By itself; taken alone.

Persona non-grata: Person not wanted; unwelcome person. Per incuriam: Through want of care; through inadvertance.

Prima facie: At first sight; on the face of it.

Profits a prendre: A right for a man in respect of his tenement.

Pro bono publico: For the public good.

Pro forma: As a matter of form.

Pro rata: In proportion.

Posteriori: From the consequences to the antecendent.

Puisne mortgage: Second mortgage.

Pari causa: Similar circumstances, with equal right.

Pari materia: Relating to same person or thing.

Qui facit per alium facit per se: He who acts through another is deemed to be acting by himself.

Quo warranto: By what authority. A writ calling upon one to show under what authority he holds or claims an office.

Quia timet: Because he fears; An action by which a person may obtain an injunction to prevent or restrain some threatened act which would cause him substantial damage. E.g. anticipatory bail.

Quid pro quo: Something for something.

Ratio decidendi: Principle or reason underlying a decision.

Res judicata: A decision once rendered by a competent court on a matter in issue between the parties after a full enquiry should not be permitted to be agitated again.

Res ipsa loquitur: The thing speaks for itself.

Respondeat superior: Let the principal be liable/answer.

Res sub judice: Matter in course of trial.

Res gestae: Facts surrounding or relevant to a case and admissible as evidence.

Rule nisi: A rule which will become imperative and final unless cause to be shown against it.

Scire facias: Your cause to know.

Status quo: The in which things are, or were.

Scientiet volenti non fit injuria: Injury is not done to one who knows and wills it.

Spes successionis: A mere hope or chance of a person to succeed as heir on the death of another.

Supra: Above; this word occurring by itself in a book refers the reader to a previous part of the book.

Suppressio veri: Suppression of previous knowledge or truth.

Sui juris: Of his own right.

Simpliciter: Simply; without any addition; unconditionally.

Scienter: Being aware of circumstances, the knowledge of which is necessary to make one liable, as applied to the keeper of a vicious dog, means no more than reasonable cause to apprehend that he might commit the injury complained of.

Sine qua non: An indispensable condition; a thing which is absolutely essential.

Situs: Position, situation, location.

Suo motu: On its own motion.

Stare decisis: Precedent. Literally let the decision stand.

Sine die: Without a day being appointed.

Travaux preparatotries: Preparatory records.

Tortum: Civil wrong actionable without contract.

Uberrimae fide: Of utmost good faith; of the fullest confidence.

Ubi jus ibi remedium: Where there is a right, there is a remedy.

Ultra vires: Beyond the scope, power or authority.

Ut lite pendente nihil innovertur: Nothing new to be introduced during ligitation.

Usufructuary: One who has the use and reaps the profits of property, but not ownership.

Ut res magis valeat quam pereat: The words of a statue must be construed so as to give a sensible or reasonable meaning to them.

Vis major: Act of God; irresistable forces.

Vigilantibus, non dormientibus, jura subveniunt: The laws help those who are vigilant and not those who are slumber or lazy.

Vice versa: The order being reversed; other way round.

Volenti non fit injuria: Damage suffered by consent gives no cause of action.

FOUNDATION PROGRAMME

ELEMENTS OF BUSINESS LAWS AND MANAGEMENT

FP–EBLM/2007

TEST PAPERS

This Test Paper set contains two Test Papers, Test Paper 1/2007 and 2/2007. Students should attempt One Test Paper only. The maximum time allowed to attempt the Test Paper is 3 hours.

W A R N I N G

It is brought to the notice of all the students pursuing Company Secretaryship Course that they should follow strict discipline while writing response sheets to the Test Papers appended herewith in this Study Material. Any attempt of unfair means by students in completing the postal coaching by way of submitting response sheets in different handwritings or by way of copying from the study material/suggested answers supplied by the Institute or from the answers of the students who have already completed the course successfully, etc., will be viewed seriously by the Institute. Students are, therefore, advised to write their response sheets in their own handwriting without copying from any original source.

Students may note that use of any malpractice while undergoing postal or oral coaching is a misconduct as per certain provisions of Company Secretaries Regulations and accordingly the registration of such students is liable to be cancelled or terminated.

FOUNDATION PROGRAMME

ELEMENTS OF BUSINESS LAWS AND MANAGEMENT

TEST PAPER 1/2007

PART A

(Answer Question No. 1 which is COMPULSORY and any two of the rest from this part.)

Time allowed: 3 hours *Maximum marks: 100*

1. (a) State, with reasons in brief, whether the following statements are correct or incorrect.
   (i) Besides minors and persons of unsound mind, there are others too who are disqualified from contracting by law.
   (ii) If the consideration to an agreement is furnished by a stranger and not by the promisee himself, the agreement will be void.
   (iii) The liability of a sleeping partner is limited.
   (iv) An auctioneer can refuse to accept the highest bid.
   (v) A preference shareholder does not have a right to vote on every resolution of the company.
   (vi) Agency by ratification arises when the principal ratifies the act of the agent. *(2 marks each)*

   (b) Write short notes on *any two* of the following :
   (i) Anticipatory breach of contract
   (ii) Goodwill of business
   (iii) Negotiation *(4 marks each)*

2. (a) No one can give what he himself has not. Elucidate. *(5 marks)*

   (b) Some furniture was delivered by X to A on hire purchase basis so that he could become owner after the payment of the last instalment. A sold the furniture to B even before such payment. A failed to make the last payment. X wanted to recover the furniture from B. Would he succeed? *(3 marks)*

   (c) Kushal delivered some jewellery to Chaman for his approval. Chaman pledged the same with Alok. Kushal wants to get back the jewellary from Alok. Would he succeed? *(3 marks)*

   (d) What is a hundi? Describe some of the important hundis. *(4 marks)*

3. (a) Choose the most appropriate answer from the given options in respect of the following:
   (i) A agrees to buy from B a certain horse for Rs.1,000. It turns out that horse was dead at the time of bargain, though neither party was aware of the fact. This agreement is :

— Valid

— Voidable

— Void

— None of the above

(ii) The leading case on the point that minor's agreement is void *ab initio*, is :

— Carlil v. Carbolic Smoke Ball Company

— Mohoribibi v. Dharamdas Ghose

— Nash v. Inman

— None of these

(iii) In a contact through sea, where the seller has to put the goods on board ship at his own expenses, the contract is known as :

— F.O.B. Contract

— C.I.F. Contract

— Ex-ship Contract

— None of these

(iv) An endorsement made by an endorser by signing his name and also by writing the name of the endorsee, is known as :

— General endorsement

— Special endorsement

— Restrictive endorsement

— None of these.

(v) A partner may retire from an existing firm :

— With the consent of all partners

— As per express agreement

— By written notice in partnership at will

— All of the above. *(1 mark each)*

(b) (i) What is the difference between a bailment and pledge?

(ii) Does sharing of profits by a person make him a partner in a firm?

(iii) What is a material alteration in a negotiable instrument?

(iv) When is the notice of dishonour necessary?

(v) Distinguish between a sale and an agreement to sell.

(vi) When is consent said to be free? *(1 mark each)*

(c) What is the difference between dissolution of partnership and dissolution of firm? *(4 marks)*

4. (a) Summarise the provisions relating to Annual General Meeting. *(4 marks)*

(b) Explain the meaning of perpetual succession and a common seal in the case of a company. *(4 marks)*

(c) The Board of directors of a public company met on three times in the previous year, the fourth meeting though called, but not held for want of quorum on two occasions successively. Discuss whether any of the provisions of the Companies Act have been contravened? *(3 marks)*

(d) What is the significance of Prospectus? State the matter to be stated in the Prospectus? *(4 marks)*

PART B

(Answer Question No.5 which is COMPULSORY and any two from the rest of this part.)

5. (a) State with reasons whether the following statements are true or false:
   (i) The business of every business is to earn profits only.
   (ii) Division of labour is the chief feature of an organization.
   (iii) A good personnel policy needs to be both stable and flexible.
   (iv) Staffing function is the same as human resources management function in an organisation.
   (v) Functional organisation means division of tasks in a department on the basis of functional specialization.
   (vi) Compensation function is concerned with the reconciliation of interest of personnel with that of the organization. *(2 marks each)*

   (b) Write short notes on *any two* the following
   (i) Steps in the process of rational decision making
   (ii) Significance of forecasting as an aid to planning.
   (iii) Line and staff organization *(4 marks each)*

6. (a) Distinguish between the following:
   (i) 'Delegation' and 'decentralisation'.
   (ii) 'Autocratic' and 'democratic' styles of leadership.
   (iii) Selection and recruitment. *(2 marks each)*

   (b) Why is control necessary in an organisation? State briefly the steps involved in control process. *(4 marks)*

   (c) Discuss McGregor's Theory X and Theory Y assumptions of human nature. How do these assumptions affect the behaviour of managers towards their subordinates? *(5 marks)*

7. (a) Choose the most appropriate answer from the given options in respect of the following:
   (i) Policies are instruments of planning for :
   — Achieving pre-determined goals
   — Innovation of a new product
   — Solving complex problems
   — Systematic approach to better decision-making

(ii) A wider span of management has the advantage of :
— Flexibility and adaptability to changing situations
— Avoiding conflict among various departments
— Promoting specialisation and operational efficiency
— All of the above

(iii) Staffing as a managerial function primarily involves :
— Selection of personnel
— Appraisal of personnel at periodic intervals
— Manpower development efforts undertaken by the enterprise
— All of the above

(iv) In "line and staff" organisation, the authority lies in :
— Line
— Staff
— Both line and staff
— Neither line nor staff

(v) A combination of project organisation and functional organisation is called as :
— Matrix organisation
— Flat organisation
— Functional organisation
— Tall organization *(1 mark each)*

(b) What is meant by organisation development? Identify the important characteristics of organisation development. *(5 marks)*

(c) What do you understand by the term 'policy? Explain its features and state its importance in management? *(5 marks)*

8. (a) How is morale related to productivity? How will you proceed to ascertain the state of current morale of your employees? *(5 marks)*

(b) Discuss the role of planning in management. What are the important characteristics of planning? *(5 marks)*

(c) Identify the areas in which objectives of performance and results of the business have to be set. *(5 marks)*

TEST PAPER 2/2007

PART A

(Answer Question No. 1 which is COMPULSORY and any two of the rest from this part.)

Time allowed: 3 hours *Maximum marks: 100*

1. (a) Attempt *any three* of the following:
   (i) Explain what is meant by negotiation? How is it effected? Can an overdue instrument be negotiated?
   (ii) Risk prima facie passes with property. Elucidate.
   (iii) "Company Secretary is the conscious keeper of the Board of Directors." Explain.
   (iv) What are the remedies available to an aggrieved party in case of fraud?

   (4 marks each)

   (b) Write short notes on *any two* of the following:
   (i) Wagering agreement
   (ii) Sale by sample
   (iii) Goodwill. *(4 marks each)*

2. (a) What is meant by 'specific goods'? State the rules regarding passing of property from a seller to a buyer in a contract for the sale of specific goods. *(4 marks)*

   (b) Ajay found a defective video camera lying in a park. He pledged it with Vijay for Rs.3,000. Mohan, the real owner, came to know about it. Mohan sued Vijay to recover his camera. Ajay had incurred Rs.500 on repair to make the camera operational. Can Mohan recover his camera?

   (3 marks)

   (c) What are quasi-contracts? State and discuss their nature and kind.

   (5 marks)

   (d) Arun is a shopkeeper. He enters into a contract with Bhanu, the wholesaler, for the supply of crackers worth Rs.1 lakh on the condition that the delivery must be made atleast 7 days before Diwali. Arun also makes known to Bhanu that if he fails to deliver the crackers in time, he is likely to suffer a loss of profit of Rs.25,000 which Arun expected to earn from the sale of crackers during Diwali season. But Bhanu supplies cracker 3 days after Diwali. Now Arun sues Bhanu for the loss of profit. Will Arun succeed? Give reasons. *(3 marks)*

3. (a) Can a partner be expelled? If so how? What are the rights and liabilities of an expelled partner? *(6 marks)*

   (b) A partner retired from a firm telling the other partners that old letter heads showing his name must not be used. The other partners in fact, used

those letter heads. Is he liable to the third parties? *(3 marks)*

(c) On a bill of exchange for Rs.10,000, Sumit's acceptance to the bill is forged. Amit takes the bill from his customer in good faith and for consideration before the bill becomes payable. State with reasons whether Amit can receive the amount of the bill from Sumit. *(3 marks)*

(d) A B & Co. is a newly constituted firm and commences business without registration. Y is indebted to the firm in the sum of Rs.500. The firm files a suit against Y for the recovery of the said sum and immediately thereafter gets itself registered. Will the firm succeed? (3 marks)

4. (a) Choose the most appropriate answer from the given options in respect of the following:

(i) A contract with the minor, which is beneficial for him is:

— Void *ab initio*

— Voidable

— Valid

— Illegal

(ii) A bailment of goods can be made by its owner of:

— Movable goods only

— Immovable goods only

— Both of these

— None of these

(iii) A partnership firm is compulsorily dissolved where:

— All partners have become insolvent

— Firm's business has become unlawful

— The fixed term has expired

— In cases (a) and (b) only

(iv) Delivering the keys of a godown in which goods sold are stored amounts to:

— Actual delivery

— Symbolic delivery

— Delivery by attornment

— None of the above

(v) Implied agency arises:

— Out of necessity

— From the conduct of the parties

— By operation of law

— All the above *(1 mark each)*

(b) Distinguish between any three of the following:

(i) Condition and warranty

(ii) Noting and protest

(iii) Misrepresentation and fraud

(iv) A wager and a contingent contract. *(2 marks each)*

(c) A & B were partners in a firm dealing in piece goods. A purchased piece goods which he knew were stolen and which belonged to C. The goods were sold by A to customers of the firm. B did not know anything about the purchase of the stolen goods or any dealing in respect of them on behalf of the firm. C sues B in respect of goods purchased by A. Advice.

(4 marks)

PART B

(Answer Question No.5 which is COMPULSORY and any two of the rest from this part.)

5. Attempt the following:
   (i) Steps in the process of rational decision making.
   (ii) Significance of forecasting as an aid to planning.
   (iii) Line and staff organization.
   (iv) Characteristics of a good personnel policy.
   (v) Causes and remedies for human resistance to change. *(4 marks each)*
6. Distinguish between the following:
   (i) 'Delegation' and 'decentralisation'.
   (ii) 'Autocratic' and 'democratic' styles of leadership.
   (iii) 'Financial audit' and 'management audit'.
   (iv) 'Selection' and 'recruitment'.
   (v) 'Training' and 'development'. *(3 marks each)*
7. (a) What is meant by organisation development? Identify the important characteristics of organisation development. *(5 marks)*
   (b) Effective coordination is a matter of judicious application of general principles. Discuss. *(5 marks)*
   (c) What do you understand by decision-making? Explain the essential steps in decision-making. *(5 marks)*
8. (a) "Good communication is the basis for sound management." Discuss. Enumerate the essentials of an effective communication. *(5 marks)*
   (b) Choose the most appropriate answer from the given options in respect of the following:
      (i) Effective implementation of plans involves:
         — Review and adjustment of organisation structure
         — Assignment of responsibility and delegation of authority
         — Leadership for implementation
         — All of the above
      (ii) Specialised staff represents:
         — Professional specialists

— Functional specialists
— Supervisory cadre
— Administrative authority

(iii) Communication is a central tool for:
— Advancement of opportunities
— Concerning skills and knowledge
— Achieving cordination and control
— All of the above

(iv) The managerial function of directing involves:
— Executive and administrative functions
— Integration of individual and organisational needs
— Responsibility of higher authorities for the acts of their subordinates
— All of the above

(v) Leadership is a cohesive force which:
— Holds the group intact
— Energies human action
— Converts despair into hope
— All of the above *(1 mark each)*

(c) Elucidate the factors that have persuaded businessmen to consider their responsibilities and the conditions which were favorable to the development of businessmen's concern with social responsibilities.

(5 marks)

FOUNDATION PROGRAMME

ELEMENTS OF BUSINESS LAWS AND MANAGEMENT

QUESTION PAPERS OF PREVIOUS SESSIONS

Question papers of immediate past two examinations of Elements of Business Laws and Management paper are appended to this study material for reference of the students to familiarize with the pattern and its structure. Students may please note that answers to these questions should not be sent to the Institute for evaluation.

JUNE 2010

Time allowed : 3 hours *Maximum marks : 100*

Total number of questions : 8

PART A

(Answer Question No.1 which is COMPULSORY and ***ANY TWO*** *of the rest from this part.)*

1. (a) State, with reasons in brief, whether the following statements are correct or incorrect. Attempt **any five** :

   (i) Performance of the terms and conditions of an offer amounts to acceptance.

   (ii) Agreement to sell is an executed contract.

   (iii) Post-dated cheque is a valid negotiable instrument.

   (iv) A sleeping partner is not liable to the third parties for the debts of the firm.

   (v) An agreement entered into with a minor may be ratified on his attaining age of majority.

   (vi) A company can be appointed as a director of another company.

   (vii) An agent is a mere connecting link between the principal and a third party. *(2 marks each)*

   (b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :

   (i) The person who gives the guarantee is called the _____.

   (ii) When neither the bailor nor the bailee is entitled to any remuneration, such a contract is known as _____ bailment.

   (iii) A government company is one in which not less than _____ per cent of the paid-up share capital is held by the government.

   (iv) The communication of the offer may be general or _____.

(v) Delivery of goods means _____ transfer of possession of goods from one person to another. *(1 mark each)*

(c) Aman, Raman and Chaman were joint-owners of a truck and possession of the said truck was with Raman. Sudhir purchased the truck from Raman without knowing that Aman and Chaman were also co-owners of the truck. Decide in the light of the provisions of the Sale of Goods Act, 1930 whether the sale between Raman and Sudhir is valid. *(5 marks)*

2. Distinguish between **any three** of the following :
   (i) 'Void agreement' and 'illegal agreement'.
   (ii) 'Negotiability' and 'assignability'.
   (iii) 'Company' and 'club'.
   (iv) 'Sale' and 'hire-purchase'. *(5 marks each)*
3. Attempt **any three** of the following :
   (i) Explain the provisions of the Companies Act, 1956 relating to appointment of directors by the Board of directors.
   (ii) What is 'customary law' ? How will you classify customs ?
   (iii) Suresh, an agent, has authority from his principal Bhupesh to sell goods on credit. Suresh sells goods on credit to Chandan without making proper enquiries about Chandan's financial status. At the time of sale, Chandan was insolvent. Is Suresh under a liability to compensate his principal Bhupesh ? Why ?
   (iv) Explain the essentials of partnership. *(5 marks each)*
4. Attempt **any three** of the following :
   (i) Summarise the provisions of the Companies Act,1956 relating to an extra-ordinary general meeting of a public limited company.
   (ii) What is the concept of quantum meruit ?
   (iii) When must the banker refuse payment of a cheque ?
   (iv) "Registration of partnership firm is not compulsory, yet it is desirable." Comment. *(5 marks each)*

PART B

*(Answer Question No. 5 which is COMPULSORY and **ANY TWO** of the rest from this part.)*

5. (a) State, with reasons in brief, whether the following statements are correct or incorrect. Attempt **any five** :
   (i) Planning is removing uncertainties and risk about future.
   (ii) Informal organisations exist away and outside the formal organisations.
   (iii) Organisational structure should not be static.
   (iv) Organisation development includes management development.
   (v) Co-ordination is the essence of management.
   (vi) Recruitment means rejection of candidates.

(vii) Decision making involves choosing the best among various alternatives. *(2 marks each)*

(b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :

(i) Management is an _____ system because it is affected by and affects environment.

(ii) Planning is an _____ process because it involves conceptualisation of the problem, identification and selection of options and design of action programme.

(iii) Informal communication is also known as _____.

(iv) Two important means of directing are (a) orienting the employees, and (b) _____.

(v) Zero base budgeting means budgeting from _____.

(1 mark each)

(c) Explain either of the following :

(i) Essential elements of controlling

(ii) Laissez faire approach of leadership. *(5 marks)*

6. Distinguish between the following :

(i) 'Motivation' and 'morale'.

(ii) 'Delegation' and 'decentralisation'.

(iii) 'Policies' and 'procedures'. *(5 marks each)*

7. Attempt **any three** of the following :

(i) What is 'manpower planning' ? What are its main benefits ?

(ii) Define 'span of control'. What factors influence the span of control ?

(iii) Discuss briefly misuse of committees.

(iv) "Effective co-ordination is a matter of judicious application of general principles." Discuss. *(5 marks each)*

8. Attempt **any three** of the following :

(i) What is 'performance appraisal' ? Explain the method of appraisal by results.

(ii) What is 'resistance to change' ? How can it be overcome by management ?

(iii) Explain 'financial audit' and 'management audit'.

(iv) Discuss the steps involved in the effective communication process.

(5 marks each)

DECEMBER 2010

Time allowed : 3 hours Maximum marks : 100

PART A

*(Answer Question No.1 which is COMPULSORY and **ANY TWO** of the rest from this part.)*

1. (a) State, with reasons in brief, whether the following statements are true or false. Attempt **any five**:
   (i) Law is static, not dynamic.
   (ii) Communication of offer, is complete when letter of offer is posted.
   (iii) A firm cannot be appointed as director of any company.
   (iv) A partly-paid seller is not known as an unpaid seller.
   (v) Order instruments can be negotiated by delivery only.
   (vi) Wagering agreements are nothing but ordinary betting agreements.
   (vii) As per the Indian Partnership Act, 1932, a minor cannot be admitted as a partner in the partnership firm. *(2 marks each)*

   (b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):
   (i) Minor's _____ is liable for necessaries provided to him.
   (ii) A sub-agent is a person employed by the _____.
   (iii) An individual, at any point of time, cannot hold directorship of more than _____ public companies.
   (iv) A cheque must, usually, be presented within _____ months.
   (v) Law means a _____ of rules. *(1 mark each)*

   (c) Define the term 'consideration' as per the Indian Contract Act, 1872. Can a stranger to consideration sue upon the contract? *(5 marks)*

2. Distinguish between **any three** of the following :
   (i) 'Coercion' and 'undue influence'.
   (ii) 'General lien' and 'particular lien'.
   (iii) 'Sale' and 'agreement to sell'.
   (iv) 'Negotiation' and 'assignment'. *(5 marks each)*

3. Attempt **any three** of the following :
   (i) Summarise the provisions relating to annual general meeting.
   (ii) What is a 'hundi' ? Describe, some of the important types of hundis.
   (iii) Ashok, Vijay and Ganesh are partners in a firm running a chemist shop. Vijay buys three pair of shoes from Sturdy Shoe Store in the name of the firm on credit. Will the firm be liable to make the payment ? Give reasons.
   (iv) Explain, in brief, the various methods of crossing of a cheque.
   (5 marks each)

4. Attempt **any three** of the following:
   (i) Raman purchases a pastry from Standard Pastry Shop. It contained a

piece of stone which broke one of Raman's teeth. What remedy has Raman against the shop-keeper ? Give reasons.

(ii) Anil gives a guarantee to Kamal in January for supply of goods worth Rs. 10,000 to Vimal on credit basis. The playment was to be made in April. However, Vimal made the payment in March itself and again took goods on credit basis from Kamal for the same amount but failed to pay. Now, Kamal files a suit against Anil for the payment. Will Kamal succeed ? Give reasons.

(iii) When a banker must refuse payment of a cheque ?

(iv) "No one can pass a better title than he himself has." Comment.

(5 marks each)

PART B

*(Answer Question No. 5 which is COMPULSORY and **ANY TWO** of the rest from this part.)*

5. (a) State, with reasons in brief, whether the following statements are true or false. Attempt **any five**:

(i) Planning is a pervasive function of management.

(ii) Leadership is the same thing as managership.

(iii) Controls are always bad and, therefore, resented.

(iv) Both responsibility and authority can be delegated.

(v) Motivation and morale are conceptually different.

(vi) Coordination is not a function of management.

(vii) A good personnel policy should be both stable and flexible.

(2 marks each)

(b) Re-write the following sentences after fllling-in the blank spaces with appropriate word(s)/figure(s):

(i) Leadership is the activity of_____ people.

(ii) Chester Barnard is the pioneer of _____ approach to management.

(iii) Theory-X is based on _____ assumptions about human nature.

(iv) Henri Fayol has divided all activities of industrial enterprise into _____ groups.

(v) The English word 'motivation' has been derived from the Latin word _____ which means to move. *(1 mark each)*

(c) Discuss the importance of communication in management. What are the essentials of effective communication? *(5 marks)*

6. Distinguish between **any three** of the following:

(i) 'Formal organisation' and 'informal organisation'.

(ii) 'Financial audit' and 'management audit'.

(iii) 'Recruitment' and 'selection'.

(iv) 'Delegation' and 'decentralisation'. *(5 marks each)*

7. Attempt **any three** of the following :

(i) Explain the main steps in the process of decision-making.

(ii) Describe the various essential elements for a good control system.

(iii) Discuss important reasons of resistance to change.

(iv) Explain the term 'zero base budgeting' (ZBB). *(5 marks each)*

8. Attempt **any three** the following :

(i) Explain the four pillars of classical theory of organisation.

(ii) Describe the nature and scope of project management.

(iii) Discuss the rationale of assuming social responsibility.

(iv) Elucidate the principles of direction. *(5 marks each)*