UNIT I FUNDAMENTALS OF BUSINESS

CHAPTER 1 HISTORICAL BACKGROUND OF COMMERCE IN THE SUB-CONTINENT

"வாணிகம் செய்வார்க்கு வாணிகம் பேணிப்
பிறவும் தமபோற் செயின்". – குறள் 120

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Couplet:
The true merchandise of merchants is to guard and do by the things of others as they do by their own.

Learning Objectives

To enable the students to

i. gain knowledge about the historical background of commerce in the sub continent

ii. learn the hindrances of commerce and trade

iii. know about the features of barter system

1.01 Introduction

Commerce has been in practice since time immemorial. It is part and parcel of human life, whether it is a king or a common man. It emerged as an economic activity, mainly as barter system which means exchange of goods for goods. It was so comfortable for neighbouring villages, states, even countries to practice barter in the absence of a medium of exchange in the form of money today. However, the concept of money occupied its predominance when scarce resources were to be either exchanged between parties in need or countries in demand and over a period of time barter economy took the dimension of monetary economy where money was used as a medium of exchange of goods and services.

The growth of civilization witnessed the rise and fall of many dynasties, but still the course of commerce activities continued further and further, not only within a country, but also between nations of the world. However Tamil Nadu remained to be the founder of trade and commerce both within and outside as evidenced in various ancient literatures like Sangam.

The whole of commerce activity emerged from barter system into a multi dimensional and multifaceted scientific system consisting of courses like Monetary system, Mail-order business, Hire purchase system, Instalment purchase system and so on. In a technology driven society today again the course of commerce activities is heading for a cashless system through e-commerce, which means business activities enabled through electronic modes like Online trading, Mobile banking and e-marketing.

In this context, it is all the more important for any student to learn the historical background of the growth and development of commerce in the country in general and in Tamil Nadu in particular. An attempt is made in this chapter to explain such a history so as to ascertain the magnitude of commerce today.

The earliest trading population of India was Indus valley people, who used the word 'trade'. The word vaniyam or vanipam would have had a Dravidian origin. The early Tamils produced their products and goods in their lands and bartered their surplus and that is how trade came into existence. The word 'Vanigam' has been widely used in sangam literature like Purananuru and Thirukkural. The Tamil – Brahmi inscriptions from Alagarmalai, Pugalur, Mangulam and Sri Lanka illustrate the fact that trade in gold, oil, plough, cloth etc.was conducted during the early age.

Trade in Sangam period was both internal and external but it was conducted by means of barter (pandamattru) Trade was one of the major means of linking various regions in the medieval period. Sangam work refers to great traders, their caravans, security force, markets, marts and guilds of such great traders. The important articles which the then hilly tribes offered to their neighbours in exchange were honey and roots and fruits while pastoral people offered cattle, milk and milk products. Cattle served as money for sometimes during the same period. Most of the inland trade was done in salt as a medium of exchange under barter mode. Paddy too served as a medium of exchange

The important trade routes of the silk and spices, blocked by the Ottoman Empire in 1453 with the fall of Constantinople and the Byzantine Empire, led to the search for a sea route across the Atlantic skirting Africa.

for a certain period. There was dependence and interdependence among the people in matters of trade and commerce. Barter system cemented their relationship internally while coins were used later for the purpose of exchange of goods in external trade.

Trade and Traders in the Pandiya Dynasty

Trade and commerce was so common to Pandiya Dynasty. Information collected from the diaries of foreign travellers, voyagers, mariners and adventurers of the ancient world highlighted the prosperity of trade in the Pandiya country. The Hebrew and Latin literature, archaeological remains in Aden, Alexandria, Java, Sumatra and even China add support to the fact of existence of trade network in the Pandiya country. Trade in copper, cloth, salt, flower, sandal wood, fish, paddy, cereals, pearls, etc flourished during their period. The place where the goods were sold was called

'Angadi' in their period. Day market was called as Nalangadi while the night market was called as Allangadi according to Saint Poet Ilango in Silapathigaram, Madurai–Kanchi. He described Madurai as iruperu neyamath meaning sleepless city due to round the clock business activities.

Coastal Trade in Ancient Tamil Nadu

Big cities like Poompuhar had the 'Maruvurappakam' (inland town) and 'Pattinapakkam' (coastal Town), had market and bazaars where many merchants met one another for the purpose of selling or buying different kinds of commodities and food stuff. Port towns like Tondi, Korkai, Puhar and Muziri were always seen as busy with marts and markets with activities related to imports and exports. In such a brisk trade, people of the coastal region, engaged themselves in coastal trade and developed their intercontinental trade contacts. They were engaged in different kinds of fishing pearls, and conches and produced salts and built ships. Boats like 'Padagu', 'Thimil', 'Thoni', 'Ambu' 'Odampunai' etc… were used to cross rivers for domestic trade while Kalam, Marakalam, Vangam, Navai etc.. were used for crossing oceans for foreign trade.

Important Ancient Trade Centres in Tamilnadu

i. Alagankulam (Ramanathapuram)
ii. Mylarphan (Mylapore, near Chennai),
iii. Keberis (Kaveripumpattinam),
iv. Poduke or Poduce (Arikamedu, Puducherry),
v. Soptana (Marakanam),
vi. Nikam (Nagapattinam),
vii. Periyapattinam,
viii. Kayalpattinam,
ix. Colchi (Korkai)
x. Comari (Kanyakumari)

Role of the Government during Ancient Tamil Nadu

Foreigners who transacted business were known as Yavanars. Arabs who traded with Tamil were called 'Jonagar'. Pattinappalai praised Kaveripumpattinam as a city where various foreigners of high civilization speaking different languages assembled to transact business with the support of the then Kingdom.

The role of the State in trade related to two aspects namely adequate infrastructure to sustain the trade and administrative machinery for taxation. During the Sangam period, the main trade routes were passing through thick forests over western ghats. The State protected the merchant caravans on these trade routes from robbers and wild

ALAMBARAI

Location: Situated 20 kms south east of Maduranthakam in Kanchipuram District.

Significance: It was once a flourishing place of commerce. A mint also existed.

life. Main roads known as Peruvali were built for surface transportation. Besides state expanded infrastructure for shipping such as ports, lighthouse, warehouse etc.. to promote overseas trade. Many such ports were developed during the Sangam period. Kaveripumpattinam was the chief port of the Kingdom of Cholas while Nagapattinam, Marakannam, Arikamedu etc. were other small ports on east coast. Similarly Pandiyas developed Korkai, Saliyur, Kayal, Marungaur pattinam and Kumari for foreign trade. The State Govertments installed check posts to collect customs along the highways and the ports.

Contribution of 'Kautilya' to Trade

''Kautilya's Arthasastra" describes economy in Mauriyan time. This brought out history of marketing practised some 2000 years ago. According to Kautilya, trade in Medieval India was centralized. Since the commodities produced could not be sold in the location of production, the state designated certain places for selling the commodities. It levied duties on goods brought into the city and could be sold after payment of duty. Only certain merchants were authorized to engage in trade to sell at prices fixed by the chief controllers of State Trading. The profit margin allowed for traders ranged between 5 per cent for indigenous goods and 10 per cent for imported goods. Import of foreign goods was encouraged to enhance the standard of living of people. Kautilya gave importance for the State in relation to treasury, taxation, industry, commerce, agriculture and conservation of natural resources. Arthasathra focused on creation of wealth as the means to

Important Ancient Trade Centres In The Coastal Regions Of Tamil Nadu

1. Alambarai
2. Alagankulam
3. Pumpuhar
4. Marakkanam
5. Vasavasamudram
6. Mylapore

ALAGANKULAM

Location: A village situated on the east coast of Bay of Bengal – Ramanathapuram district. Attankarai – confluence of river Vaigai situated near Sri Lanka

Significance: Findings - large number of potsherds of mediterranean origin

Roman coins of Valentine II, Arcadius & Theodosius II Pot sherds with Roman ship graffiti. Sherds with two lady figurines identified with Egyptian origin. Tamil brahmi sherds with Ceylon brahmi scripts are found in an ancient Roman port. The department carried out excavations in eight seasons and the collected artefacts revealed Indo-Roman trade contact.

promote the well being of the state. He advocated maintenance of perfect balance between State management and people's welfare through trading activities.

Commerce and Trade in North India

India was prosperous even during the medieval period from 12th to 16th centuries despite political upheavals. Balban was the first sultan who paved the way in the

POOMPUHAR

The southern Coromandel Coast mostly within the territory of Tamilnadu state is thick with history.This history is not only of the European colonization but goes back to the ancient times when many places along the coast were centres of international trade. One such place which is said to have flourished from 200 BC onwards is Poompuhar. The seaside town which was once the second capital of the Chola Dynasty and a major centre of international trade with both eastern and western people. Silk appears to be a major item of exports from here. The ancient port as destroyed and is now found by the archaeologists submerged off the coast for up to 5 km. Erosion of land or a Tsunami was cited as possible causes.

dense forest and helped traders and their commercial caravans to move from one market place to others. Alauddin Khilji brought the price to a very low ebb. He encouraged import of foreign goods from Persia and subsidised the goods. Arabs were dominant players in India's foreign trade. They never discouraged Indian traders like Tamils, Gujaratis, etc.. The Trade between the coastal ports were in the hands and Marwaris and Gujiratis. The overland trade with central and west Asia was in the hands of Multanis who were Hindus and Khurasanis who were Afghans, Iranians and so on. During Sultanate period, trade flourished due to the establishment of currency system based on silver and copper. Moorish traveller described the teeming market of big cities in the Gangetic plains, Malwar, Gujarat and South India. The important trade centres were Delhi, Mumbai, Ahmedabad, Sonar, Sonargoon, Jaunpur, Lahore and so on. The burgeoning foreign trade led to the development of market place in the towns and villages. India's handicraft commanded a good foreign market. India imported horses, dry fruits, precious stones, glassware, high grade textiles, raw silk, corals, scented oil, velvets, etc.. from Kabul, Arabia, Europe, West Asia and China. Indian products were exported to East Africa, Malaya, China and Far East. Trade was conducted through overland roots with Afghanistan, Central Asia and Persia India conducted foreign trade via land route with Quetta, Khyber pass, Iraq and Bukhara. The traders of Malabar, Gujarat and foreign settlers in the ports of Calicut, Khumbat and Mangalore controlled a major business sector in port cities.

Trade with Rome, China and Europe

Roman and Greek traders frequented the ancient Tamil country and forged trade relationship with ancient Kings of Pandiya, Chola and Chera dynasties. Cholas had a strong trading relationship with Chinese Song Dynasty. The cholas conquered the Sri Vijaya Empire of Indonesia and Malaysia to secure a sea trading route to China.

During the 16th and 18th centuries, India's overseas trade expanded due to trading with European companies. The discovery of new all - sea routes from Europe to India via Cape of Good Hope by Vascoda Gama had far – reaching impact on the civilized world. The arrival of Portuguese in India was followed by the advent of other European communities. India's maritime trade was a monopolized one over Europeans and at one stage the global trade share of India was 55 per cent which is just 2 per cent in 21st century. The European merchants who came to India were not only individual merchants but also represented their respective governments. They gained a strong foothold in India's maritime trade by virtue of their strong naval power. In course of time their commercial motives turned into territorial ambition like the East India Company which became the British Empire here.

Textiles and ship building earned name and fame in the 17th and 18th centuries. Britishers gradually abolished Princely order in the Indian territories. Thus the demand for Indian goods declined during the British rule. Britishers put in place policies prohibiting the export of some of the popular goods like Indian textile goods, handicrafts, to Great Britain. Between early 1600 and mid – 19th century, the British East India company led establishment and expansion of foreign trade all over Asia. Although initial interest of the East India Company was aimed at reaping profits, their single minded focus was on establishing a trade, monopoly throughout Asia Pacific made them heralding agent of British Colonial Imperialism.

1.02 Barter System

Goods were exchanged for goods prior to invention of money. Barter system worked on certain conditions mentioned below.

1. Each party to barter must have surplus stocks for the trade to take place.
2. Both the buyers and sellers should require the goods each other desperately i.e., double coincidence of wants
3. Buyer and seller should meet personally to effect the exchange.

Constraints in Barter System

The barter system envisages mutual exchange of one's goods to other without the intervention of money as a medium of exchange. It imposes certain constraints in the smooth flow of trade as explained below.

1. Lack of double coincidence of Wants

Unless two persons who have surplus have the demand for the goods possessed by each other, barter could not materialize. For instance 'A' is having a surplus of groundnut and 'B' is possessing rice in surplus. In this case A should be in need of rice possessed by B as the latter should desperately need groundnut possessed by A. If this "coincidence of wants" does not exist, Barter cannot take place.

2. Non – existence of common measure of value

Barter system could not determine the value of commodities to be exchanged as they lacked commonly acceptable measures to evaluate each and every commodity. It was difficult to compare the values of all articles in the absence of an acceptable medium of exchange.

3. Lack of direct contact between producer and consumers

It was not possible for buyers and sellers to meet face to face in many contexts for exchanging the commodities for commodities. This hindered the process of barter in all practical sense.

4. Lack of surplus stock

Absence of surplus stock was one of the impediments in barter system. If the buyers and sellers do not have surplus then no barter was possible.

Invention of Money

All the aforesaid constraints were addressed by the invention of money as medium of exchange. Besides there are other hindrances in the smooth exchange of goods from the place of production to the place of consumption like place, time, risk, knowledge, finance and so on. These are addressed by various mechanisms in detail in the subsequent sections of this chapter.

1.03 Hindrances of Commerce

Production of goods and services for the satisfaction of human wants is the main objective of an industry. Reaching those goods and services to the people for where these are produced is the object of commerce. Commerce serves as a valuable link between the producer and the consumer. It renders a variety of services to ensure that the passage of goods and services between the two, is completed without any let or hindrance. Accordingly, commerce may be defined as "the organized system for the exchange of goods and services between members of industrial world." It comprises all forms of trade, wholesale, retail, import, export and entrepreneurial services which aid and assist the trading activities such as banking, transport, warehousing, insurance, and advertising.

1.04 Elimination of Hindrances of Commerce

Business consists of all industries and commerce. It serves to remove several hindrances and solve many problems while facilitating the production and distribution of goods. The various hindrances removed by business are as follows

1. Hindrance of person

Manufacturers do not know the place and face of the consumers. It is the retailer who knows the taste, preference and location of the consumers. The chain of middlemen consisting of wholesalers, agents and retailers establish the link between the producers and consumers.

2. Hindrance of place

Production takes place in one centre and consumers are spread throughout the country and world. Rail, air, sea and land transports bring the products to the place of consumer.

3. Hindrance of time

Consumers want products whenever they have money, time and willingness to buy. Goods are produced in anticipation of such demands. They are stored in warehouses in different regional centres so that they can be distributed at the right time to the consumers.

4. Hindrance of risk of loss

Fire, theft, floods and accidents may bring huge loss to the business. Insurance companies serve to cover the risk of such losses.

5. Hindrance of knowledge

Advertising and communication help in announcing the arrival of new products and their uses to the people.

6. Hindrance of finance

Producers and traders may not have the required funds at the time of their need. Banks and other financial institutions provide funds and help in transfer of funds to enable the functioning of business smoothly.

Key Terms

Vanigam Nalangadi

Allangadi Hindrances

Barter system

Exercise

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I. Choose the Correct Answer

1. In Pandiyas Dynasty the place where the goods are sold is ______

a) Angadi

b) Market

c) Nalangadi

d) Allangadi

2. Hindrance of place is removed by ______

a) Transport b) Warehouse

c) Salesman d) Insurance

3. Who wrote "Arthasasthra" ?

a) Kautilya

b) Kambar

c) Thiruvalluvar

d) Elangovadigal

4. Trade and Commerce was common to ______ Dynasty.

a) Pallava

b) Chola

c) Panidya

d) Chera

5. ______ was first sultan who paved way in the dense forest and helped traders to move from one market place to others place for their commercial caravans.

a) Balban

b) Vascoda Gama

c) Akbar

d) Alauddin Khilij

Answers

1. a   2. a   3. a   4. c   5. a

II. Very Short Answer Questions

1. What is meant by Barter System?
2. What is meant by Nallangadi?
3. What is meant by Allangadi?

III. Short Answer Questions

1. Explain the meaning of the term "Vanigam".
2. State the meaning of Maruvurapakkam and Pattinapakkam.
3. What are the ports developed by Pandiya kingdom?

IV. Long Answer Questions

1. What are the hindrances of Commerce? (any 5)
2. State the constraints in barter system.
3. Briefly explain the coastal trade in ancient Tamilnadu.

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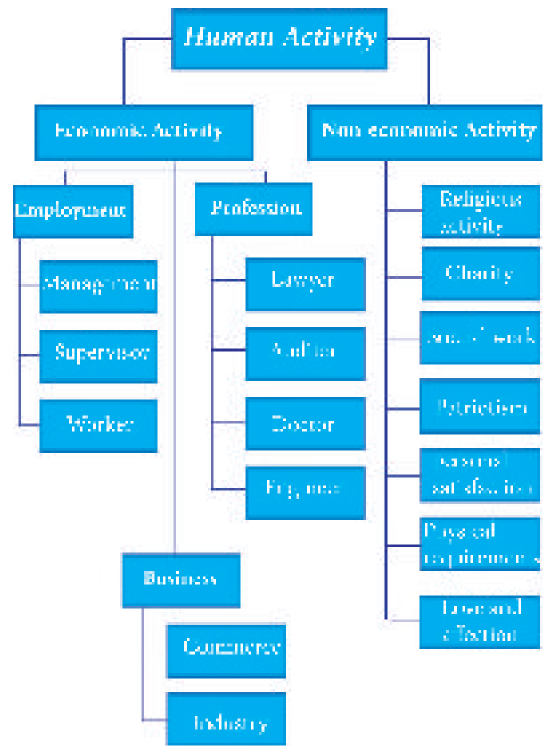
CHAPTER 2 OBJECTIVES OF BUSINESS

Learning Objectives

To enable the students to

i. know the meaning of human activities and its kinds
ii. learn the Economic Vs Non-Economic Activities
iii. know the types of Economic Activities Employment, Profession and Business
iv. understand the concept of business
v. explain the characteristics of business activities
vi. analyse the objectives of business
vii. elucidate the comparison of business, profession and employment



2.01 Introduction

Human Activities

Human activity is an activity performed by a human being to meet his/her needs and wants or may be for personal satisfaction. Human activities can be categorised into economic and non-economic activities. The chart below gives a snapshot of human activities.

I. Economic Activities

Activities undertaken with the object of earning money are called economic activities.

Examples:

i. Production of goods by manufacturers
ii. Distribution of goods by wholesalers
iii. Selling by retailers
iv. Medical advice rendered by physicians
v. Accounting practice by chartered accountants

II. Non-Economic Activities

Activities undertaken to satisfy social and psychological needs are called non-economic activities.

Examples:

i. Cooking food for family
ii. Celebrating festivals

Economic Activity Vs. Non-Economic Activity

Economic Activities	Non-Economic Activities
1. Definition: Economic activities are those activities which are undertaken to earn money or financial gain for livelihood. **e.g.,** Fruit seller selling fruits	Non-economic activities are those activities which are undertaken for the sake of pleasure, performed out of love, sympathy, sentiments etc. **e.g.,** Mother cooks for her family
2. Motive: Sole motive is to earn money or financial gain. **e.g.,** Working as a lawyer.	Undertaken for satisfaction of social, psychological or emotional needs. **e.g.,** Visit to a temple
3. Money Measurement: All economic activities can be valued in monetary terms. **e.g.,** Doctor charges ₹500 as consultation fee.	Non-economic activities cannot be valued in monetary terms. These are an expression of a thought, feeling or a gesture. **e.g.,** An NGO distributes free clothes to poor children
4. Relationship: Economic activities are related to creation of wealth. **e.g.,** Ram saved part of his salary to purchase a house of his own.	Non-economic activities do not create wealth. **e.g.,** Money received as donation is spent on charity work.
5. Outcome: All economic activities result in production, procurement, distribution and consumption of goods and services. **e.g.,** Nokia produces cell phones and sells across India through its distributors.	The end result of a non-economic activity is the mental, emotional or psychological satisfaction of the person doing the activity. **e.g.,** Sona enjoys teaching orphans in an orphanage.
6. Duration: Economic activities are repetitive. They are done on a regular basis to earn a living. **e.g.,** Kulfi ice cream seller sells ice creams every evening.	Non-economic activities may not be undertaken regularly. Usually they are done during free time. **e.g.,** Sankar visits orphanage in his free time.
7. **Source of Initiation:** Economic activities are initiated to satisfy human needs and wants.	Non-economic activities are initiated to satisfy emotional or sentimental pleasures.

iii. Watching movies in a theatre
iv. Doing meditation

2.02 Types of Economic Activities

Economic activities are undertaken to earn money. Generally, people engage themselves in such activities on a regular basis and are said to be engaged in their occupation. Occupations may be classified into three categories based on the following:

A. Employment
B. Profession
C. Business

A. Employment

It refers to the occupation in which people work for others and get remuneration in the form of wages or salaries. The one who is employed by others are called employees and the one who employs others is called employer.

Managers, Clerks, Bank officials, Factory workers etc., are examples of employees.

Characteristics

There is a contract existing between the employer and the employee. Employee performs according to assigned task. Remuneration is given to employees for delivering value of services. An employee must abide by the rules and regulations of the organization.

B. Profession

Professions are those occupations which involve rendering of personal services of a special and expert nature. A profession is something which is more than a job. It is a career for someone who is competent in their respective areas. It includes professional activities which are subject to guidelines or codes of conduct laid down by professional bodies. Those engaged in a profession are called professionals and they earn income by charging professional fee.

Characteristics

There should be a systematic body of knowledge. There should be formal acquisition of knowledge by the members. There should be a code of conduct governing the conduct and behaviour of professionals. Service motive should be uppermost in the minds of people rendering professional service.

C. Business

Business refers to any human activity undertaken on a regular basis with the object to earn profit through production, distribution, purchase and sale of goods and services.

Business may be defined as "an activity involving regular production or purchase of goods and services for sale, transfer and exchange with an object of earning profit".

According to **James Stephenson** business refers to "Economic activities performed for earning profits."

According to **H.Haney**, "Business may be defined as a human activity directed towards producing or acquiring wealth through buying and selling of goods".

Business activities are connected with raising, producing or processing of goods. Industry creates form utility to goods by bringing materials into the form which is useful for intermediate consumption (i.e., further use of material in order industry) or final consumption by consumers.

Classification

Business activities are classified on the basis of size, ownership and function.

1. Activities on the Basis of Size

On the basis of size, business activities may be broadly grouped into two categories.

a. Small Scale

Small scale units require less capital. They employ small number of workers and produce the goods on small scale. Example: Manufacturing textiles in handlooms or power looms.

(i) Extraction of edible oil from seeds like groundnut, sesame, through treditional wooden churner.

b. Large Scale

Large scale units require huge capital. They employ large number of workers and produce the goods on large scale.

Examples

(i) Manufacturing Textiles in a large Textile mill. Example. Raymonds, Ramraj Cotton

(ii) Extraction of edible oil from oil seeds in oil mills. Example. Suffola, Sunflower

2. Activities on the Basis of Ownership

On the basis of ownership business activities may be broadly grouped into three categories.

a. Private Enterprises

An enterprise is said to be a private enterprise where it is owned, managed and controlled by persons other than Government.

(i) Sole proprietorship. Example - Sundar Stationeries

(ii) Partnership firms. Example - Ramesh Bros.

b. Public Enterprises

An enterprise is said to be a public enterprise where it is owned, managed and controlled by Government or any of its agencies or both. Public enterprises may be organized in several forms such as,

(i)Departmental undertaking - Public Works Department (PWD)

(ii)Public Corporation - Oil and Natural Gas Corporation (ONGC)

(iii)Government Company - State Trading Corporation (STC)

c. Joint Enterprises

An enterprise is said to be a joint enterprise where it is owned, managed and controlled by Government and private entrepreneurs.

3. Activities on the Basis of Function

On the basis of functions, business activities may be broadly grouped into two categories.

a. Industry

Industry includes all those business activities which are connected with raising, producing or processing of consumer goods. Example - bread, butter, cheese, shoes, or capital goods like machinery.

b. Commerce

It establishes a link between the producers and consumers of goods and maintains a smooth and uninterrupted flow of goods from producers to consumers.

2.03 Characteristics of Business

The essential characteristics of business are as follows:

i. Production or Procurement of Goods

Goods must be produced or procured in order to satisfy human wants.

ii. Sale, Transfer or Exchange

There must be sale or exchange of goods or services. When a person weaves cloth for his personal consumption, it is not business because there is no transfer or sale.

iii. Dealing in Goods and Services

Goods produced or procured may be consumer goods like cloth, pen, brush, bag etc., or producer-goods like plant and machinery. Services refer to activities

Comparision of Business, Profession and Employment

Business	Profession	Employment
1. Nature of Work: Goods and services provided to the public	Personalized service of expert nature	Performing work assigned by the employer
2. Qualifications: No minimum qualification is essential	Education and training in specialized field	Minimum qualification is essential
3. Capital: Capital investment required as per size of the firm	Limited capital necessary for establishment	No capital required
4. Reward: Profits	Professional fee	Salary or wages
5. Risk: Profits are uncertain and irregular	Fee is regular and certain, never negative	Fixed and regular pay, no risk
6. Transfer of Interest: Transfer possible with some formalities	Not possible	Not transferable

like supply of electricity, gas or water, transportation, banking, insurance etc.

iv. Regularity of Dealings

An isolated dealing in buying and selling does not constitute business. The transactions must be regular. For example, if a person buys a scooter for his use and later on disposes it of at a profit, he cannot be said to have been engaged in business. The buying and selling must be recurrent to constitute business.

v. Profit Motive

An important feature of business is profit motive. Business is an economic activity by which human beings make their living. It is, in fact, the attraction of profit which spurs people to do business.

vi. Element of Risk

The profit that is expected in a business is always uncertain because it depends upon a number of factors beyond the control of the businessman. For example, change in consumer preference, shortage of raw materials, transport bottlenecks, power-crisis etc., may upset business calculations and result in loss. That is why profit is said to be reward for risk-taking. Thus any business activity includes an element of risk too.

2.04 Objectives of Business

Every business enterprise has certain objectives which regulate and generate its activities. Objectives are needed in every area where performance and results directly affect survival and prosperity of a business. Various objectives of business may be classified into five broad categories as follows;

A. Economic Objectives

Economic objectives of business refer to the objective of earning profit and also other objectives that are necessary to be pursued to achieve the profit objective, which includes creation of customers, regular innovations and best possible use of available resources.

B. Social Objectives

Social objectives are those objectives of business, which are desired to be achieved for the benefit of the society. Since business operates in a society by utilizing its scarce resources, the society expects something in return for its welfare. No activity of the business should be aimed at giving any kind of trouble to the society.

C. Organizational Objectives

The organizational objectives denote those objectives an organization intends to accomplish during the course of its existence in the economy like expansion and modernization, supply of quality goods to consumers, customers' satisfaction, etc.

D. Human Objectives

Human objectives refer to the objectives aimed at the well-being as well as fulfillment of expectations of employees as also of people who are disabled, handicapped and deprived of proper education and training. The human objectives of business may thus include economic well-being of the employees, social and psychological satisfaction of employees and development of human resources.

E. National Objectives

The goal of the country may be to provide employment opportunity to its citizen, earn revenue for its exchequer, become self-sufficient in production of goods and services, promote social justice, etc. Business activities should be conducted keeping these goals of the country in mind, which may be called national objectives of business.

Key Terms

Human Activities
Economic Activities
Non-Economic Activities
Business
Profession
Employment

For Own Thinking

Do you know that there are white collar, blue collar, pink collar jobs? Collect the information and discuss.

Exercise

I. Choose the Correct Answer

1. The Primary objective of a business is

a. Making Profit
b. Not Making Profit
c. Special skill
d. None of the above

2. Occupation of a Doctor is

a) Employment
b) Business
c) Profession
d) Sole Proprietor

3. The following does not characterise business activity?

a) Production of goods and services

b) Presence of Risk

c) Sale or exchange of goods and services

d) Salary or wages

4. Activities undertaken out of love and affection or with social service motive are termed as:

a) Economic activities
b) Monetary activities

c) Non Economic Activities

d) Financial Activities

Answers

1. a   2. c   3. d   4. c

II. Very Short Answer Questions

1. What is meant by Economic Activities?
2. What do you mean by Business?
3. What do you mean by Employment?

III. Short Answer Questions

1. What do you mean by human activities? Explain.
2. Write a short notes on:

   a) Business   b) Profession

3. Explain the classification of 'Business'.

IV. Long Answer Questions

1. Explain the characteristics of Business. (any 5)
2. Compare business with profession and employment. (any 5)
3. Discuss the objectives of business.

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CHAPTER 3

CLASSIFICATION OF BUSINESS ACTIVITIES

பொருள்கருவி காலம் வினையிடனொடு ஐந்தும்
இருள்தீர எண்ணிச் செயல். -குறள் 675

Couplet:
Do an act after a due consideration of the (following) five, viz. money, means, time, execution and place.

Learning Objectives

To enable the students to

i. describe the classification of business activities
ii. understand the meaning of Industry:
iii. classify the industries into primary, secondary and tertiary industries
iv. compare industry, commerce and trade
v. explain the auxiliary activities in commerce

Introduction

The manufacturers produces the goods for the consumers at one point of location. They distribute the goods to final consumer through intermediaries like wholesaler, retailers, distributors and the like. All these process taking place from the point of production to the point of consumption are collectively called as business activities. All business activities can be classified into two broad categories i.e., Industry and Commerce.

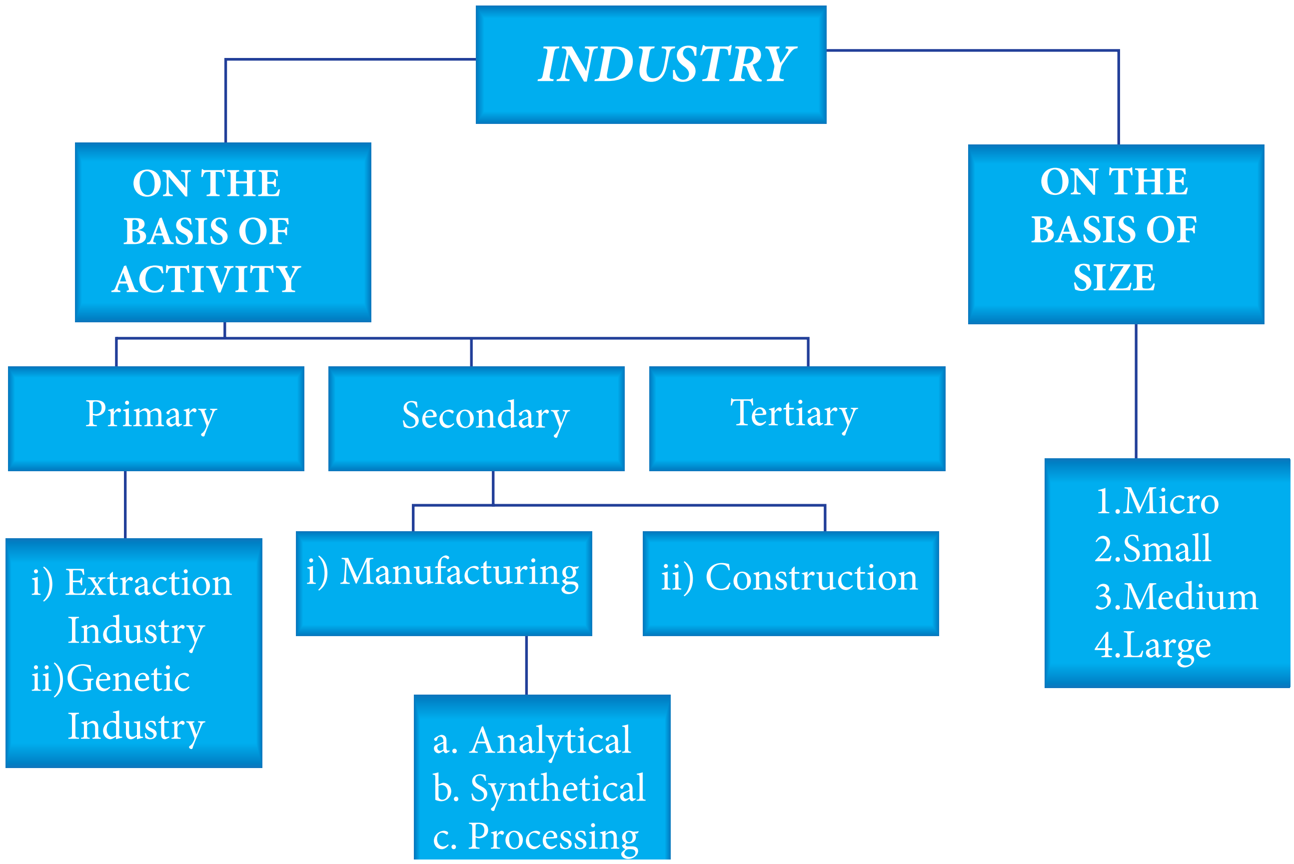
3.01 Industry

Industry refers to economic activities, which are connected with conversion of resources into useful goods. The production side of business activity is referred as industry. Generally the term industry is used for activities in which mechanical appliances and technical skills are involved. These include activities relating to producing or processing of goods as well as breeding and rising of animals.

The term industry is also used to mean group of firms producing similar or related goods. For example, cotton textile industry refers to all manufacturing units producing textile goods from cotton. Similarly, electronic industry would include all firms producing electronic goods, and so on. Further, in common parlance, certain services like banking and insurance are also referred to as industry, say banking industry, insurance industry etc.

Kinds of Industries

Industries may be classified into two broad categories,



A) On the Basis of Activities and
B) On the Basis of Size

A) On the Basis of Activities

Industries may be divided into three wide categories namely 1. primary industries,

2. secondary industries and 3.tertiary industries.

1. Primary Industries

Primary industry is concerned with production of goods with the help of nature. It is a nature-oriented industry, which requires very little human effort, For example Agriculture, farming, forestry, fishing, horticulture, etc. These industries may be further sub divided as follows:

(i) Extractive Industries

These industries extract or draw out products from natural sources. Extractive industries

supply some basic raw materials that are mostly products of geographical or natural environment. Products of these industries are usually transformed into many other useful goods by manufacturing industries. Important extractive industries include farming, mining, oil drilling, hunting and fishing operations.

(ii) Genetic Industries

These industries remain engaged in breeding plants and animals for their use in further reproduction. The seeds,

nursery companies, poultry, diary, piggery, hatcheries, nursery, fisheries, apiary etc are classic examples of genetic industries.

2. Secondary Industries

These are concerned with using the materials which have already been extracted at the primary stage. These industries process such materials to produce goods for final consumption or for further processing by other industrial units. For example mining of an iron ore is a primary industry, but manufacturing of steel by way of further processing of raw irons is a secondary industry. Secondary industries may be further divided as follows:

(i) Manufacturing Industries

These industries are engaged in producing goods through processing of raw materials and thus creating form utilities. They bring out diverse finished products, which we consume or use, through the conversion of raw materials or partly finished materials in their manufacturing operations. Manufacturing industries may be further divided into four categories on the basis of method of operation for production.

a. **Analytical Industry** which analyses and separates different elements from the same materials, as in the case of oil refinery.

b. **Synthetic Industry** which combines various ingredients into a new product, as in the case of cement.

c. **Processing Industry** which involves successive stages for manufacturing finished products, as in the case of sugar and paper.

d. **Assembling Industry** which assembles different component parts to make a new product, as in the case of television, car, computer, etc.

(ii) Construction Industries

These industries are involved in the construction of building, dams, bridges, roads, as well as tunnels and canals.

3. Tertiary industries or Service industries

They do not produce goods. These industries produce utility services and sell them at a profit. They help trade, industry and commerce. This term also includes auxiliaries to trade like banking, insurance, warehouse, advertisement etc.

Classification of Tertiary industries

i. **Personalised service**: Individuals and private institutions selling their services to others. E.g. plumber, servant maid, etc.

ii. **Public Service**: Government hospitals, schools, police, Government offices, etc. provide services to the people on behalf of the Government without profit motive.

iii. **Distributive Service**: Transportation, warehousing, logistics, salesmanship, etc. come under this type of service.

iv. **Financial Service**: Banking, factoring, accounting, and insurance, etc. are grouped under this type of service.

v. **Quaternary Service**: Professional or specialised skills and high technology are used to provide this type of service.

E.g. Software development, Auditing, Research and Development, etc.

vi. **Quinary Service:** New ideas are generated, new technologies are evolved, new policies are implemented by selected individual experts. Their decisions influence nations, international institutions, etc. i.e., Inventors.

B) On the basis of Size

On the basis of size or scale of operations industries may be classified as follows

1. Micro Industries
2. Small Industries
3. Medium Industries and
4. Large Industries

3.02 Commerce

Commerce refers to all those activities which are necessary for bringing goods from the place of production to the place of their consumption. According to Evelyn Thomas, "Commercial operations deal with the buying and selling of goods, the exchange of commodities and the contribution of finished products". Commerce includes not only trade but also services such as transport, warehousing, packaging, insurance, banking and sales promotion which are incidental or auxiliaries to trade. Refer to chapter 2. Commerce includes the following activities as briefly explained below

3.03 Trade

i) Trade

Trade is an essential part of commerce. The term 'trade' is used to denote buying and selling. It helps in making the goods produced available to ultimate consumers or users. Therefore, one who buys and sells is a trader. A trader is a middleman between the producer and the consumer. Trade may be classified into internal trade and external trade, wholesale trade or retail trade.

ii. Transportation

Selling all the goods produced at or near the production place is not possible. Hence, goods are to be sent to different places where they are demanded. The medium which moves men and materials from one place to another is called transport.

iii. Banking

Now-a days we cannot think of business without bank. To start the business or to run it smoothly we require money. Banks supply money. Business activities cannot be undertaken unless funds are available for acquiring assets, purchasing raw materials and meeting other expenses. Necessary funds can be obtained from bank. Thus, banking helps business activities to overcome the problem of finance.

iv. Insurance

Business involves various types of risks. Factory building, machinery, furniture etc, must be protected against fire, theft and other risks. Materials and goods held in stock or in transit are subject to the risk of loss or damage. Employees are also required to be protected against the risks of accident and occupational hazards. Insurance provides protection in all such cases. On payment of a nominal premium, the amount of loss or damage and compensation for injury if any, can be recovered from the insurance company.

Comparison between Industry, Commerce and Trade

INDUSTRY	COMMERCE	TRADE
1. **Meaning:** Extraction, reproduction, conversion, processing and construction of useful products	Activities involving distribution of goods and services	Purchase and sale of goods and services
2. **Scope:** Consists of all activities involving conversion of materials and semi-finished products into finished goods.	Comprises trade auxiliaries to trade	Comprises exchange of goods and services
3. **Capital:** Generally large amount of capital is required	Need for capital is comparatively less	Small capital is needed to maintain stock and to grant credit
4. **Risk:** Risk involved is usually high	Relatively less risk is involved	Relatively less risk is involved
5. **Side:** It represents supply side of goods and services	It represents demand side of goods and services	It represents both supply and demand
6. **Utility creation:** It creates form utility by changing the form or shape of materials	It creates place utility by moving goods from producers to consumers	It creates possession utility through exchange

v. Warehousing

Usually, goods are not sold or consumed immediately after production. They are held in stock to make them available as and when required. Special arrangement must be made for storage of goods to prevent loss or damage. Warehousing helps business firms to overcome the problem of storage and facilities the availability of goods when needed. Prices are thereby maintained at a reasonable level through continuous supply of goods.

vi. Communication

Communication means transmitting or exchange of information from one person to another. It can be oral or in writing. It is necessary to communicate information from one to another to finalize and settle the terms of sales such as price of goods, discount allowed, the facility of credit and so on Internet, telephone, teleconference, email play on important role in establishing contact between businessman producers and consumers.

vii. Advertising and salesmanship

Advertising frisbee knowledge cap and it solves the difficulty of information Advertising helps consumers to know about the various brand manufactured by several manufacturers The media used to advertise products for Radio, Newspapers, Magazines, Television, Internet, Billboard and so on

Salesmanship is a skillful art of selling commercial goods. It facilitates personal selling. Many times the sales force is required to book orders directly from dealer or customers.

It is very much required in the sales of services and industrial goods

Key Terms

Industry

Commerce

Trade

Exercise

I. Choose the Correct Answer

1. The industries engaged in extraction of iron ore are known as

a. Construction Industries
b. Manufacturing Industries
c. Extraction Industries
d. Genetic Industries

2. Production which involves several stages for manufacturing finished products is known as

a. Analytical Industry
b. Synthetic Industry
c. Processing Industry
d. None of the above

3. Normally high level risk involved in

a. Industry
b. Commerce
c. Trade
d. All of the above

Answers

1. c 2. c 3. a

II. Very Short Answer Questions:

1. Define Commerce.
2. What do you mean by Industry?
3. What it trade?

III. Short Answer Questions:

1. What do you mean by tertiary industries?
2. Write a short note on Transportation.

IV. Long Answer Questions:

1. Compare Industry, Commerce and Trade. (any 5)
2. Write a short notes on:
   a. Analytical industry
   b. Genetic industry
   c. Construction industry

UNIT II FORMS OF BUSINESS ORGANISATION

CHAPTER 4 SOLE PROPRIETORSHIP

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எண்ணித் துணிக கருமந் துணிந்தபின்
எண்ணுவ மென்ப திழுக்கு. – குறள் 467

Couplet:
Consider, and then undertake a matter; after having undertaken it, to say "We will consider," is folly.

Learning Objectives

To enable the students to understand

i. the Forms of Business Organisation
ii. the meaning of a Sole Trader, Characteristics, Advantages and Disadvantages

4.01 Introduction

A business organisation is an organisation which is engaged in some industrial or commercial activity. It represents an institutional arrangement for carrying on any kind of business activity. It may be owned and controlled by a single individual or by a group of individuals who have entered into a formal or informal agreement to jointly conduct the business.

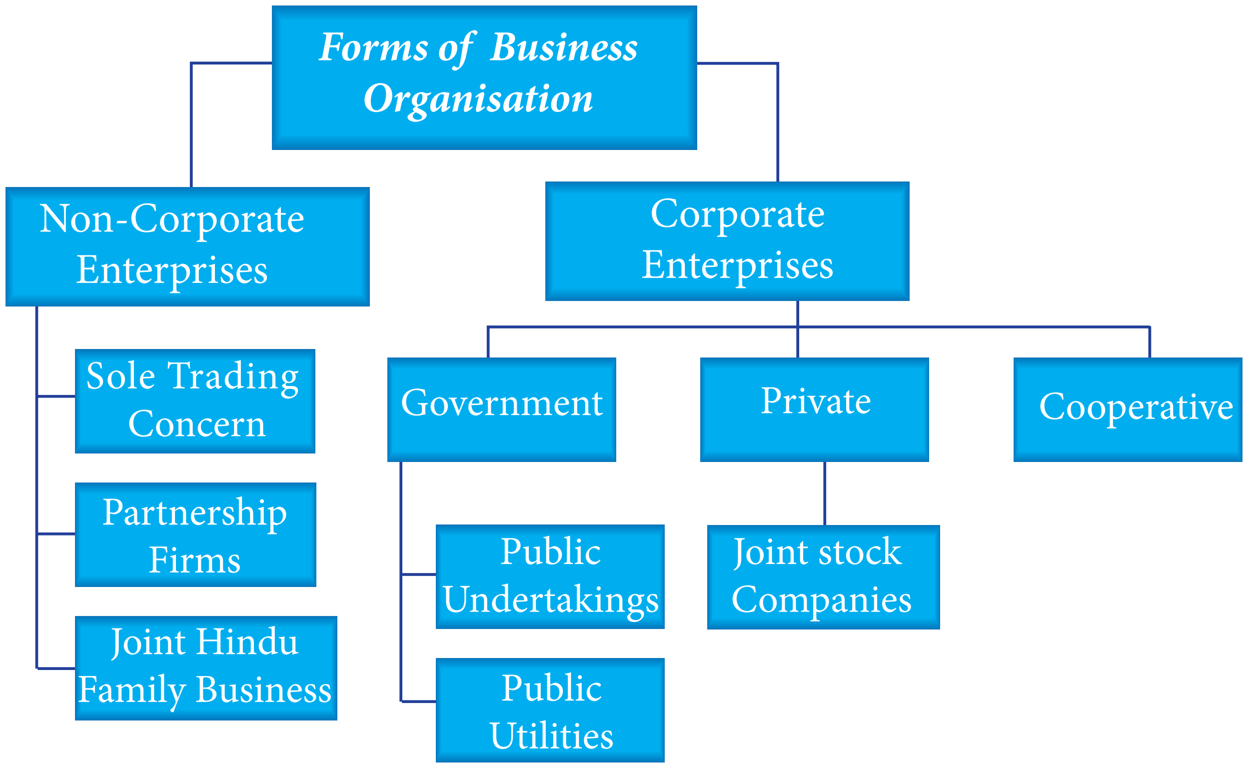
Every business undertaking is a separate and distinct business unit. It has its own identity and separate ownership. It can be distinguished from other undertakings on the basis of its ownership, management and control.

According to *Wheeler*, "a business undertaking is a concern, company or enterprise which buys and sells, is owned by one person or a group of persons and is managed under a specific set of operating policies".

All business undertakings are directly or indirectly engaged in the transfer or exchange of goods and services for value. They deal in goods and services on a regular basis. Their main motive is to earn profits and they are exposed to various types of risks.

Sole Trading Business

Sole Proprietorship is a form of business organisation in which an individual introduces his own capital, uses his own skill and intelligence in the management of its affairs and is solely responsible for the results of its operations. The individual alone may run the business or may obtain the assistance of employees. It is the first stage in the evolution of the forms of organisation and is, thus, the oldest among them.



It is also known as individual entrepreneurship. To raise the required capital the individual may depend mostly on his own savings, or else, he may borrow part or whole from his friends or relatives or financial institutions. The business may be started either in a portion of the proprietor's own house or in a rented premises. There are no legal formalities to be gone through except those required for a particular type of business. For example, if one wants to start a restaurant has to obtain a license from the Health Department of the Municipal Corporation.

4.02 Definition of Sole Trader

> "Sole trader is a type of business unit where a person is solely responsible for providing the capital, for bearing the risk of the enterprise and for the management of business"
>
> \- *J.L.Hansen*

> "Sole proprietorship is that form of business organisation which is owned and controlled by a single individual. He receives all the profits and risks all of his property in the success or failure of the enterprise".
>
> \- *Wheeler*

4.03 Characteristics

The following are the characteristics of a Sole Trader.

i. Ownership by one man

This is owned by single person. The sole trader contributes the required capital. He is not only the owner of the business but also manager of the entire affairs.

ii. Freedom of work and Quick Decisions

Since the individual is himself as a owner, he need not consult anybody else. Hence he can take quick decisions.

iii. Unlimited Liability

When his business assets are not sufficient to pay off the business debts he has to pay from his personal property.

iv. Enjoying Entire Profit

He strives tirelessly for the improvement and expansion of his business and enjoys all the benefits of his hard work.

v. Absence of Government Regulation

A sole proprietor concern is free from Government regulations. No legal formalities are to be observed in its formation, management or in its closure.

vi. No Separate Entity

The sole trading concern comes to an end with death, disability, insanity and insolvency of the individual.

vii. Maintenance of Secrecy

Since he/she manages all the affairs of the business, the secrecy can be maintained easily.

4.04 Advantages and Disadvantages

Advantages

The following are the advantages of a Sole trader.

i. Easy Formation

No legal formalities are required to initiate a sole trading concern. Any person capable of entering into a contract can start it, provided he has the necessary resources for it.

ii. Incentive to Work hard

There is a direct relationship between effort and reward. The fact that the entire profit can be taken by himself without sharing with anybody else induces him to work ceaselessly.

Success story of Murugappa Group

The Murugappa Group is an Indian business conglomerate, founded, managed, and largely owned by the Murugappa family. The group has 28 business concerns including eleven listed companies traded on the National Stock Exchange of India and the Bombay Stock Exchange. Headquartered in Chennai, the major companies of the group include Carborundum Universal Ltd, Cholamandalam Investment and Finance Company Ltd., Cholamandalam MS General Insurance Company Ltd., Coromandel International Ltd., Coromandel Engineering Company Ltd., EID Parry (India) Ltd., ParryAgro Industries Ltd., Tube Investments of India Limited, and Wendt (India) Ltd., and Shanthi Gears Limited (Coimbatore).

They have presence in several segments including abrasives, auto components, bicycles, sugar, farm inputs, fertilizers, plantations, bioproducts and nutraceuticals, the group has forged strong alliances with leading international companies like Groupe Chimique Tunisien, Foskor, Cargill, Mitsui Sumitomo, Morgan Crucible and Sociedad Quimica y Minera de Chile (SQM). The Group has a wide geographical presence spanning 13 states in India and five continents around across the globe.

Brands like BSA, Hercules, Ballmaster, Ajax, Parry's, Chola, Gromor and Paramfos are from the stables of Murugappa. The organisation has a workforce of over 32,000 employees.

Success story of TVS Group

TVS Motor Company is the third largest two-wheeler manufacturer in India, with a revenue of over 13,000 Cr ($2 billion) in 2016-17. It is the flagship company of the ₹40,000 Cr ($6 billion, in 2014-15) TVS Group. The company has an annual sales of 3 million units and an annual capacity of over 4 million vehicles. TVS Motor Company is also the 2nd largest exporter in India with exports to over 60 Countries. TVS Motor Company Ltd (TVS Motor), member of the TVS Group, is the largest company of the group in terms of size and turnover, with more than 3 Cr (30 million) customers riding a TVS bike.TVS was established by Mr TV Sundaram. He began with Delhi first bus service in 1911 and founded T.V. Sundaram and Sons Limited, a company in the transportation business with a large fleet of trucks and buses under the name of Southern Roadways Limited. When he died in 1955, his sons took the company ahead with several forays in the automobile sector, including finance, insurance, two-wheelers/ three wheelers, tyres and components, housing, aviation, logistics etc. The group has managed to run 97 companies that account for a combined turnover of nearly US$6 billion.

iii. Small Capital

Small capital is an important as well as specific advantage of sole proprietorship. Sole proprietor can start business with small capital.

iv. Credit Standing

Since his private properties are held liable for satisfying business debts, he can get more financial assistance from others.

v. Personal Contact with the Customers

Since sole proprietor knows each and every customer individually he can supply goods according to their taste and preferences. Thus he can cultivate personal relationship with the customers.

vi. Flexibility

The sole trader can easily adjust himself to the changing requirements of his business.

Disadvantages

The following are the disadvantages of a Sole Trader.

i. Limited Capital

Since the capital is contributed by one individual only, business operations have necessarily to be on a limited scale.

ii. Limited Managerial Skill

Single person's intelligence and experience may not help him beyond a certain stage. Since he has to focus on each and every activity, his managerial ability is bound to be limited.

iii. Unlimited Liability

The creditors have the right to recover their dues even from the personal property of the proprietor in case the business assets are not sufficient to pay their debts.

iv. Lack of Specialisation

Since the business unit is small and the financial resources are limited, experts in different fields cannot be employed to secure maximum advantages.

v. Hasty Decisions

Sole proprietor is more likely to take hasty decision as he need not consult anybody else.

Key Terms

Business Organisation
Sole Proprietorship
Unlimited Liability
Managerial Skill
Legal Entity
Credit Standing

For Own Thinking

i. How to start a snacks manufacturing unit at home?
ii. Dried Fish – Trading Explain.
iii. Individual – Independent software companies run by New graduates

Case Study

Rajendran has done his B.Com., this year. He wants to do some good business now. Kesavan, his father, is a Sole-proprietor of a small Banian-manufacturing plant in Salem and ask Rajendran to join business with him as a partner. However, Rajendran likes to go in for an independent venture. A discussion follows between them on this issue. Meanwhile Mr.Arul, an advocate and friend of Rajendran's father, comes there and gives comments on both of them. Assume the role of Rajendran, Kesavan and Arul and state and defend your positions.

For Future Learning

a. Mahesh is a young graduate who has inherited a sum of ₹1,00,000 by way of family savings. He also has a family house to which he has sole title as the only son of his father. He is thinking of starting a small factory for the manufacture of plastic toys. What form of ownership organisation will you advise him to choose?

b. Amar started a business on his own. He has his father helping him with the accounts and his brother helps him with looking after customers in the evening. Amar pays a monthly salary to his father and brother. Identify the form of business organisation.

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Exercise

I. Choose the Correct Answer

1. Which is the oldest form of Business organisation?

a. Sole Proprietorship
b. Partnership
c. Co-operative Society
d. Company

2. In which form the owner, establisher and manager is only one?

a. Joint Enterprise
b. Government Company
c. Co-operative Society
d. Sole Proprietor

3. A major disadvantage of sole proprietor-ship is ______

a. Limited liability

b. Unlimited liability

c. Easy Formation

d. Quick decision

4. From the following which one is Non-corporate form of business?

a. Joint stock company

b. Sole trading business

c. Government company

d. Co-operatives

Answers

1. a 2. d 3. b 4. b

II. Very Short Answer Questions

1. Who is called a Sole Trader?
2. What are the Non-Corporate enterprises?
3. What are the Corporate enterprises?

III. Short Answer Questions

1. How is it possible to maintain secrecy in Sole Proprietorship?
2. What is unlimited liability?
3. Give some examples of Sole trading business.

IV. Long Answer Questions

1. Explain the characteristics of Sole trading business. (any 5)
2. What are the advantages of Sole trading business. (any 5)
3. What are the disadvantages of Sole trading business.

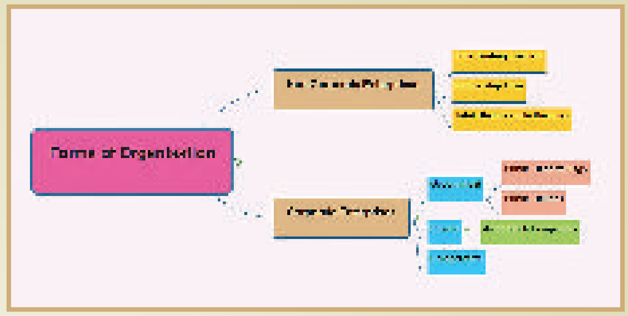
Reference

1. Kathiresan & Radha - "Business Organisation", Tenth Edition, Prasanna Publishers, Chennai.
2. Subhanjali Chopra - Business Organisation and Management

ICT CORNER

CREATE YOUR OWN MIND MAP

Create your
own Mind Map



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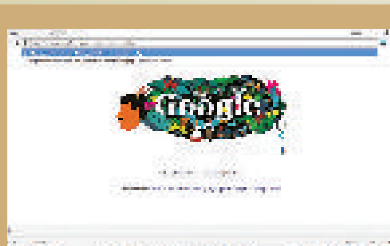
- Open the Browser and type the URL given (or) Scan the QR Code.
- EDRAW Mind Master Download page will open. Click on Download and Install the software.
- After Installing in your Computer open it and select one of the "templates" given and click "Create". You will get the required Mind Map page.
- It will show "Main Idea" box. Enter the main topic. When you move the cursor over this box "+" sign will appear. If you Click on "+" sign next branch will open. Similarly, you can create branches wherever you want. Now type the relevant titles on the boxes. Now your Mind Map is ready. Simple example is shown. If you click on "–" you can Hide the Branch and "+ " will appear. If you click "+" the branch will appear again and " – " will appear.
- You can change colour, Background and the text style. You can save and edit later as HTML format with show hide features. you can save this as pictures to use in any document.
- Explore more and make it beautiful.



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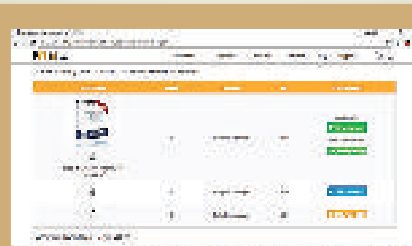

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*Images are indicative only

UNIT II FORMS OF BUSINESS ORGANISATION

CHAPTER 5 HINDU UNDIVIDED FAMILY AND PARTNERSHIP

இதனை இதனால் இவன்முடிக்கும் என்றாய்ந்து
அதனை அவன்கண் விடல். - குறள் 517

Couplet:
'This man, this work shall thus work out,' let thoughtful king command;
Then leave the matter wholly in his servant's hand.

Learning Objectives

To enable the students to

i. understand the meaning of Joint Hindu Family business, characteristics

ii. know the meaning of Partnership, characteristics, advantages and disadvantages

iii. learn partnership deed and its contents

iv. describe the rights and duties of partners

v. know the types of partnership, types of partners

vi. understand the procedures for registration, drawbacks of non-registration, dissolution of Partnership

Hindu Undivided Family

5.01 Introduction to HUF

The Joint Hindu Family Business is a distinct form of organisation peculiar to India. Joint Hindu Family Firm is created by the operation of law. It does not have any separate and distinct legal entity from that of its members. The business of Joint Hindu Family is controlled under the Hindu Law. The membership in this form of business organisation can be acquired only by birth or by marriage to a male person who is already a member of Joint Hindu Family.

Meaning of HUF

Families agree to live and work together, invest their resources and labour jointly and share profits or losses together, then this family is known as composite family or HUF

Example: C.Roy & Co (a chartered accountant firm)

There are two schools of Hindu Law-one is Dayabhaga which is prevalent in Bengal and Assam and the other is Mitakshara prevalent in the rest of the-country. According to Mitakshara law, there is a son's right by birth in the property of joint family. It means, when a son is born in the family, he acquires an interest in the property jointly held by the family. Today Hindu succession Act 2005 is applicable to all male and female members of a HUF.

Characteristics

The main characteristics of Joint Hindu Family Business are given below:

i. Governed by Hindu Law

The business of the Joint Hindu Family is controlled and managed under the Hindu law.

ii. Management

All the affairs of a Joint Hindu Family are controlled and managed by one person who is known as 'Karta' or 'Manager'. The Karta is the senior most male member of the family. The members of the family have full faith and confidence in Karta. Only Karta is entitled to deal with outsiders. But other members can deal with outsiders only with the permission of Karta.

iii. Membership by Birth

The membership of the family can be acquired only by birth. As soon as a child is born in the family, that child becomes a member. Membership requires no consent or agreement.

iv. Liability

Except the Karta, the liability of all other members is limited to their shares in the business. The amount of debt can be recovered from his personal property also.

v. Permanent Existence

The death, lunacy or insolvency of any member of the family does not affect the existence of the business of Joint Hindu Family. The family goes on doing its business.

vi. Implied Authority of Karta

In a joint family firm, only Karta has the implied authority to enter into a contract for debts and pledge the property of the firm for the ordinary purpose of the businesses of the firm.

vii. Minor also a co-parcener

In a Joint Hindu Family firm even a new born baby can be a co-parcener.

viii. Dissolution

The Joint Hindu Family business can be dissolved only at the will of all the members of the family. Any single member has no right to get the business dissolved.

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5.02 Meaning and Definition of Partnership

Introduction

Partnership form of organisation is an extension of the sole proprietorship. It has already been explained that a sole proprietary form of organisation suffers from several drawbacks such as limited capital, limited managerial ability, concentrated risk and less chances for expansion and growth etc. With the result, the sole trader is compelled to seek the co-operation of others so that he can meet the changing situations effectively. Generally when a sole trader finds it difficult to handle the problems of growth and expansion, he takes a partner. Thus it represents the next stage in the evolution of business organisation.

The persons who enter into partnership are individually called 'Partners' and collectively known as 'Firm'. According to Section 4 of the partnership Act, 1932. "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

Definition of Partnership

According to **Prof.Haney**, "The relations which exist between persons, competent to make contracts, who agree to carry on a lawful business in common with a view to private gain".

According to **Spriegal**, "Partnership has two or more members each of whom is responsible for the obligatory requirements of the partnership. Each of the partners may bind the others and the assets of the partners may be taken for debts of partnership".

Characteristics

The main characteristics of partnership are given below:

i. Contractual Relationship

Partnership is the result of an agreement, which may be oral or written. Consequently persons not competent to contract (for example, minors) cannot form it.

ii. Plurality of persons

Since partnership is the outcome of an agreement, the minimum number of

persons required to form a partnership is two. Maximum is 50

iii. Existence of business

The partnership agreement must be to carry on lawful business or a profession. If there is no business there can be no partnership. In other words, partnership is not a club or a charitable association.

iv. Sharing profits

The business must be carried on with a view to earn profit and share it among all the partners. An agreement to undertake philanthropic activities does not constitute partnership because profit motive is completely absent.

v. Mutual Agency

In fact, mutual agency is the essence of partnership. Since the business is to be carried on by all or any of them acting for all, each partner acts simultaneously as a principal and an agent. To the outsiders, he is a principal while to the other partners he is an agent.

Advantages

The main advantages of Partnership are given below:

i. Easy formation

The formation of partnership firm requires fulfillment of lesser legal formalities than other types of organisation. What required is just an agreement, which can be oral or written. Registration of partnership is optional. Further, even if a firm wants to get itself registered, the registration process is very simple.

ii. Availability of larger resources

The combined capital of all the partners and the greater borrowing capacity make available larger financial resources. New partners can also be taken into partnership to secure more capital. As a result, expansion of the business unit becomes feasible.

iii. Benefit of consultation

Two heads are better than one. Wise decision can be possible when the issues and subject matters are thoroughly discussed. There is no place for hasty decisions.

iv. Division of Work and greater managerial efficiency

The staggering load of management work can be judiciously distributed among the partners according to their experience, knowledge and taste. For example, one partner can look after purchases, another sales, yet another accounting etc. Thus when the burden is lightened, supervision by each partner over the allocated area of management becomes effective and efficient. This ensures greater managerial efficiency.

v. Reduced Risk

The risk of each partner is reduced considerably since the loss sustained by the firm is shared by all the partners.

vi. Unlimited liability and credit standing

The liability of a partner is unlimited. Since, apart from his business assets, even his private properties are also available for satisfying the claims of creditors. Hence, creditors may give more loans because they can get back the loan from the personal properties of sole traders. Thus high credit rating helps sole trader to borrow more funds from suppliers and banks.

vii. Safeguard of the Minority Interest

For all the vital matters unanimous consent of each partner is required. If there is no unanimity, such decisions are not accepted.

viii. Easy Dissolution

The dissolution of the partnership is also very simple. In the case of partnership at will, a 14 days notice by a partner in this connection is enough. No legal hurdle is there for dissolving the firm.

Disadvantages

The main disadvantages of Partnership are given below:

i. Lack of harmony

After a few years of working, friction and disharmony may creap in. Each partner vies with one another in dishonest dealings. This mutual conflict and lack of team spirit pave the way for the dissolution of the firm.

ii. Absence of Legal Status and Instability

The partnership firm has no separate legal existence. It is inseparable from the partners composing it. As a result it is terminable on the death or insolvency of a partner.

iii. Limited Resources

The maximum number of partners in a partnership firm is 10 in the case of banking business and 20 in other cases. In actual practice the number will be well below this maximum because of the need for ensuring harmonious working. In view of this, only limited resources are available. Modern large-scale enterprises which require huge capital outlay cannot be started.

iv. Limited Risk-taking

In view of the danger of unlimited liability, the partners tend to be overcautious. So, normally they do not want to assume risks starting new ventures.

v. Risk of implied authority

Every partner can bind the firm and his other partners by his acts. Therefore all other partners become liable to a greater extent because of the folly and fraud committed by a fellow partner.

vi. Lack of public confidence

As its accounts need not be audited and published, it lacks public confidence.

5.03 Partnership Deed and its Contents

Though a partnership agreement need not necessarily be in writing, it is important to have a written agreement in order to avoid misunderstandings; it is desirable to have a written agreement. A carefully drafted partnership deed helps in ironing out differences which may develop among partners and in ensuring smooth running of the partnership business. It should be properly stamped and registered.

Contents of Partnership Deed

i. Name of the Firm

ii. Nature of the proposed business

iii. Duration of partnership

Duration of the partnership business whether it is to be run for a fixed period of time or whether it is to be dissolved after completing a particular venture.

iv. Capital contribution

The capital is to be contributed by the partners. It must be remembered that capital contribution is not necessary to become a partner for one who contributes his organising power, business acumen, managerial skill etc., instead of capital.

v. Withdrawal from the firm

The amount that can be withdrawn from the firm by each partner.

vi. Profit/loss sharing

The ratio in which the profits or losses are to be shared. If the profit sharing ratio is not specified in the deed, all the partners must share the profits and bear the losses equally.

vii. Interest on capital

Whether any interest is to be allowed on capital and if so, the rate of interest. If the deed is silent on interest on capital, the rules for interest on capital in partnership act will take effect.

viii. Rate of interest on drawing

Whether any interest is to be allowed on drawing, the rate of interest is to be specifird

ix. Loan from partners

Whether loans can be accepted from the partners and if so the rate of interest payable thereon.

x. Account keeping

Maintenance of accounts and audit.

xi. Salary and Commission to Partners

Amount of salary or commission payable to partners for their services. (Unless this is specifically provided, no partner is entitled to any salary).

xii. Retirement

Matters relating to retirement of a partner. The arrangement to be made for paying out the amount due to a retired or deceased partner must also be stated.

xiii. Goodwill valuation

Method of valuing goodwill on the admission, death or retirement of a partner.

xiv. Distribution of responsibility

The work that is entrusted to each partner is better stated in the deed itself.

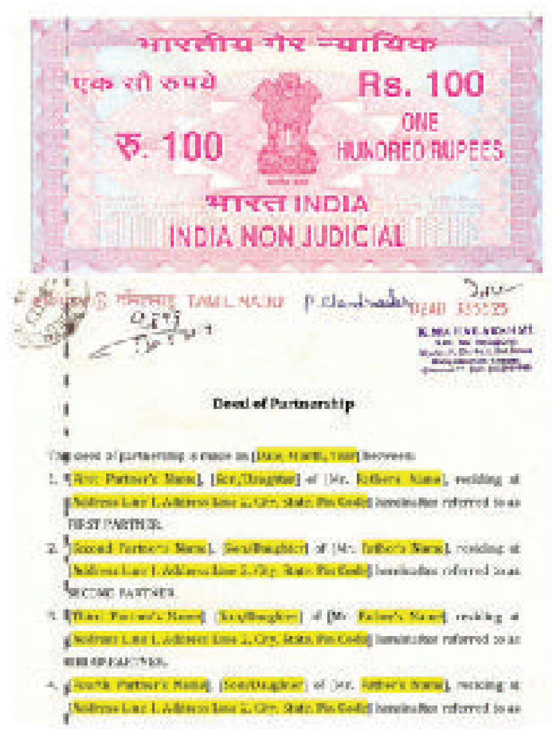
xv. Dissolution procedure

Procedure for dissolution of the firm and the mode of settlement of accounts thereafter.

xvi. Arbitration of dispute

Arbitration in case of disputes among partners. The deed should provide the method for settling disputes or difference of opinion. This clause will avoid costly litigations.

Format of Partnership Deed



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5.04 Rights and Duties of Partners

The mutual rights and obligations are usually stated in the partnership deed. In the absence of any deed, the provisions of the partnership Act as stated below will apply.

1. Rights of a Partner

i. Right to take part in business

Every partner has a right to take part in the management of the business.

ii. Right to be consulted

Every partner has the right to be consulted in all the matters concerning the firm. The decision of the majority will prevail in all the routine matters. But, where the matter is of fundamental importance such as admission of a new partner, change in the nature of business etc., decision must be unanimous.

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iii. **Right of access to books, record and document**
Every partner has the right of access to all records and books of accounts, and to examine and copy them.

iv. **Right to share profit**
Every partner is entitled to share the profits in the agreed ratio. If no profit-sharing ratio is specified in the deed, they must be shared equally.

v. **Right to receive interest**
A partner has the right to receive interest on loans advanced by him to the firm at the agreed rate, and where no rate is stipulated, interest @ 6% p.a. allowed.

vi. **Right to be indemnified**
Every partner has the right to be indemnified by the firm for all acts of other partners in the ordinary course of the business. He has a further right to receive back any amount spent by him on behalf of the firm. Only thing is he must have acted prudently.

vii. **Right to use partnership property for the business**
Every partner has the right to use partnership property for the purpose of the partnership.

viii. **Right to retire**
Every partner has a right to retire as per the terms of the deed or with the consent of the other partners. In case of partnership at will, he can retire at any time by giving prior notice to the other partners.

ix. **Right to continue**
Every partner has the right to continue in the firm. He cannot be expelled except in accordance with the Partnership Deed.

2. Duties of Partner

i. **Duty to carry on business**
Every partner has to carry on the business of the firm to the maximum advantage of all the partners.

ii. **Duty to be true**
Every partner must be true, just and faithful to one another. There must be utmost good faith and fair dealings.

iii. **Duty to render true accounts**
A partner is bound to keep and render true and full accounts of the partnership. He must produce relevant vouchers for the expenses incurred by him and hand over to the firm all amounts which have come into his hands as a partner.

iv. **Duty to indemnity the firm**
Every partner must indemnify the firm for any loss caused by his fraud or willful negligence in the conduct of the business.

v. **Duty to share the loss**
Every partner is bound to share the losses in the agreed ratio in the absence of an agreed ratio, it must be borne equally.

vi. **Duty to claim remuneration**
No partner, including a managing partner is entitled to any remuneration (salary or commission), for the work done by him, unless there is an agreement to the contrary.

vii. **Duty not to use firm's property for personal use**
The partnership property belongs to all partners. But a partner should not use the partnership property for his private purposes.

viii. Duty not to carry on competing business

No partner can carry on a competing business. If he does so, he should surrender to the firm all profits earned by him in such business. No partner is allowed to earn secret profit.

ix. Duty to act within scope of his authority

A partner must act within the scope of his authority.

x. Duty to consult other partners before assigning or transferring his interest in partnership

No partner can assign or transfer without the consent of all other partners his interest in the firm to any other person so as to make him a partner thereof.

3. Liabilities of Partner

i. Joint and Several liabilities

Every partner is jointly and severally liable for all acts of the firm. It means that in case the assets are inadequate for meeting the claims of creditors, even their personal properties should be made available. The creditors can recover their claims from all the partners.

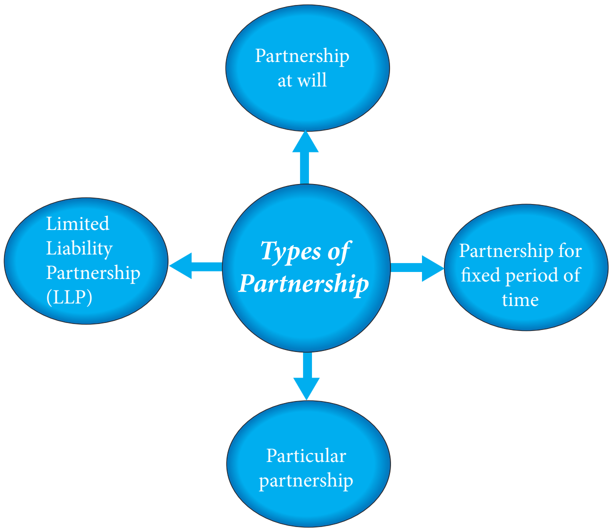
ii. Liable for any loss to third party

The firm is liable for any loss caused to a third party because of a wrongful act done in the ordinary course of business. It means that every partner is liable.

iii. Liability to third party to make good the loss

Where a partner receives money or property from a third party on behalf of the firm and misappropriates it, then the firm is liable to make good the loss.

Types of Partnership



i. Partnership at will

Partnership formed to carry on business for an undefined period is called partnership at will. In other words, no time-limit is specified for the continuance of the firm. It is to be dissolved when a partner gives notice of his intention to dissolve the partnership. Thus this type of partnership continues its business activities as long as there is mutual cooperation and confidence among partners. Since it comes to an end at the will of any partner on his giving notice, it is called partnership at will.

ii. Partnership for a fixed term

Where a partnership is formed for a definite period of time, it is known as partnership for a fixed term. The partnership for a fixed term comes to an end on the expiry of the stipulated period. But if the business is continued even after the original fixed period, it automatically becomes a partnership at will. As such it will be terminated at the will of any partners, giving notice of his intention to do so.

iii. Particular partnership

When a partnership is formed to carry on a particular venture or a business of temporary nature, it is called particular partnership. Such a firm lasts so long as the business agreed upon is not completed. In other words, it comes to an end on the completion of the particular venture. If such a firm is not dissolved and it begins to undertake new activities not originally contemplated, the rights and obligations of the partners continue to be the same as in the original partnership and it will continue till a partner gives a notice of his intention to dissolve the firm.

Limited Liability Partnership (LLP) Act, 2008

In India "The Limited Liability Partnership (LLP) Act, 2008" was published in the Official Gazette of India on January 9, 2009 and has been notified with effect from 31st March 2009. The first LLP was incorporated in the 2-4-2009.

At present, there are about 10,000 LLPs formed and registered under the Limited Liability Partnership Act.

Being the separate legislation (i.e.,LLP Act, 2008) the provisions of Indian Partnership Act, 1932 are not applicable to an LLP and it is regulated by the contractual agreement between the partners. Every Limited Liability Partnership shall use the words "Limited Liability Partnership" or its acronym "LLP" as the last words of its name.

iv. Limited Liability Partnership (LLP)

Limited Liability Partnership is very popular in the service sector and in the small scale business enterprises. Limited liability partnership means for paying the debts of the firm only the assets of the business will be utilized and not the personal properties. It is prevalent among popular professionals such as Cost Accountants, Company Secretaries, Chartered Accountants, Lawyers, Architects, Engineers and Doctors. Limited Liability Partnership is available in countries like U.S.A, Singapore, Thailand and U.K. It came into existence in India since 2008.

5.05 Types of Partners

i. Active Partner

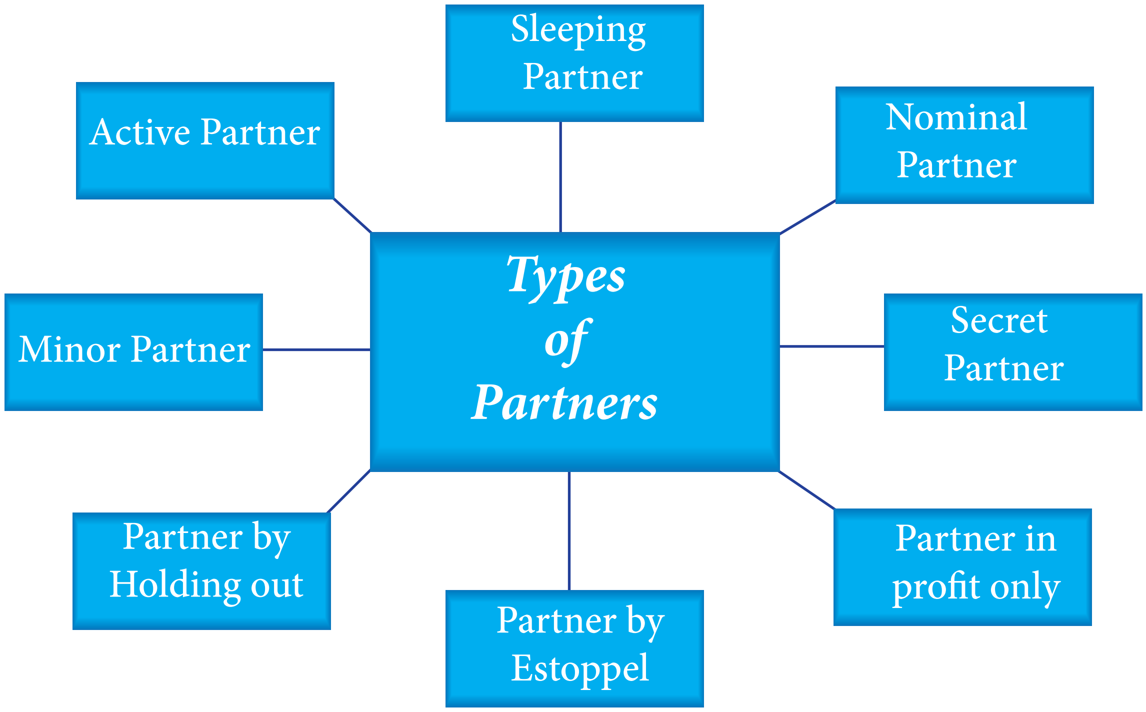
A partner who takes an active part in the conduct of the partnership business is known as an active partner. Though every partner is entitled to manage its affairs, all may not do so.

ii. Sleeping Partner or Dormant Partner

Such a partner contributes capital and shares in the profits or losses of the firm but does not take part in the management of the business. He may not be known as a partner to the outsiders; yet he is liable to third parties to an unlimited extent as any other partner.

iii. Nominal Partner

Such a partner neither contributes any capital nor is he entitled to manage the affairs of the business. He only lends his name to the firm because on the strength of his name and reputation, the firm may attract additional business and raise funds easily. A nominal partner, however,



is liable for all the acts and debts of the firm as if he were a real partner, though he does not get any share in the firm's profit.

iv. Partner in Profits only

When a person joins a firm as a partner on the condition that he is entitled to a specified share of the firm's profit only, he is called a partner in profits only. It means that he will not be called upon to bear any portion of the losses sustained. He will, however, be liable to third parties for all the debts of the firm like any other partner. Such partners usually do not take part in the management of the business.

v. Partner by Estoppel

In case, a person represents himself/herself by words or actions or has allowed him to be represented as a partner of the firm, even though he is not a partner, he is called partner by estoppels. Such a partner cannot deny his liability, if outside party lends money to the firm supposing him to be a partner.

vi. Partner by Holding out

When a person is declared as a partner and he does not deny this even after becoming aware of it, he becomes liable to the third party, who lends money or credit to the firm on the basis of such a declaration.

vii. Secret Partner

A secret partner is one whose association is not known to the general public. Other than this distinct feature, he is like rest of the partners in all respects.

viii. Minor Partner

Under the Indian Majority Act, person who has not completed 18 years of age is a minor. However, he will continue to be a minor till he completes 21 years if a guardian has been appointed to the minor. He can be admitted to the benefits of partnership.

Partnership arises as a result of contract. But a minor has no contractual capacity. Though a partnership cannot be created with a minor as a partner, a minor can be admitted to the benefits of a partnership which is already in existence. The consent of all partners is a 'must' for such admission.

Registration of Partnership

The Indian Partnership Act does not make the registration of a partnership compulsory. Registration is optional. But the disabilities of non-registration virtually make it compulsory.

5.06 Procedure for Registration

A statement should be prepared stating the following particulars.

i. Name of the firm.
ii. The principal place of business.
iii. Name of other places where the firm carried on business.
iv. Names and addresses of all the partners.
v. The date on which each partner joined the firm.
vi. The duration of the firm.

This statement signed by all the partners should be produced to the Registrar of Firms along with the necessary registration fee.

Any change in the above particulars must be communicated to the Registrar within 14 days of such alteration.

5.07 Drawbacks of Non-Registration of Partnership

i. No right to file suit against others

An unregistered firm cannot file a suit to enforce its claims against third parties, if such rights arise out of a contract. For example, no court of action is possible to recover debts from third parties. It has no right even to demand a set-off in any suit filed by its creditors.

ii. Right to sue for right arising

However it can sue others for enforcing rights arising otherwise than out of a contract. For example, it can bring a suit for wrongful infringement of trade mark of patent.

iii. Right of third parties to sue the firm

The rights of third parties against the firm are not affected by non-registration. It means that they can sue the firm or any of its partners.

A partner of an unregistered firm cannot sue the firm or other partners for enforcing his rights under the partnership deed.

However, his right to sue for the dissolution of the firm or for the accounts of a dissolved firm or for his share in the assets of a dissolved firm is not affected by non-registration.

In short, non-registration does not affect the following rights:

i. Suit not exceeding ₹100
ii. The rights of firm or partners of a firm having no place of business in India.
iii. The power of an official assignee or receiver to realise the property of an insolvent partner.
iv. Suit arising otherwise than out of contract as explained above.
v. The rights of third parties against the firms or any of its partners.
vi. Suit by a partner for the dissolution of the firm or for accounts of a dissolved firm or for a share in the assets of a dissolved firm as stated above.

Registration can be effected at any time. All the disabilities automatically disappear as soon as the firm is duly registered.

5.08 Dissolution of Partnership

Dissolution of Partnership is different from the dissolution of partnership firm. It is due to the fact that when the relation present between all partners, comes to an end, it is known as dissolution of firm. When any one of the partners become incapacitated, then the partnership comes to an end, but the firm may continue to operate, if new partnership is arranged among the other partners.

a) Dissolution of firm

Dissolution of firm means dissolution of partnership. On dissolution of firm, partnership business comes to an end. Its assets are realised and the creditors are paid off. The business cannot be continued after dissolution of partnership firm. For example A, B and C are partners in a business. If all the three partners decide to dissolve, it is known as "dissolution of the firm".

b) Dissolution of partnership

Dissolution of partnership means the termination of the original partnership agreement. A partnership is dissolved by insolvency, retirement, expiry or completion of the term of partnership. The business will continue after dissolution of partnership. For example: A, B and C are partners in a business. If 'A' retires, 'B' and 'C' can continue the business which is known as dissolution of partnership.

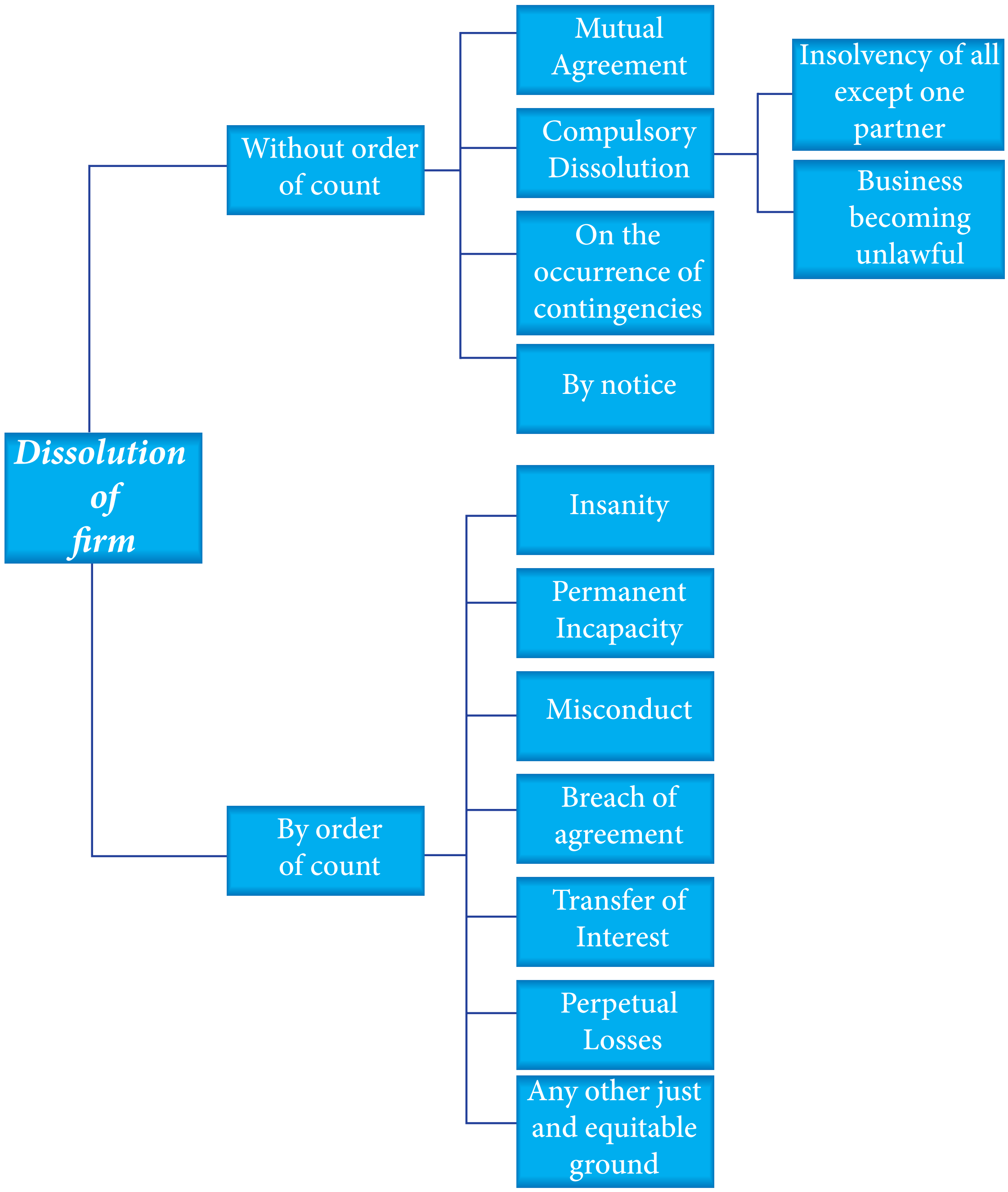
The various circumstances leading to dissolution of partnership firm can be summarised by taking the first letters used in the term "Dissolution".

D - Death of partner
I - Incapacity of a partner
S - Stipulated period of partnership completed in the case of particular partnership
S - Serious misconduct of a partner
O - Object is completed (Particular partnership)
L - Lunacy of a partner
U - Unavoidable continuous loss
T - Transfer of interest of the firm
I - Insolvency of a partner
O - Objectionable unlawful objectives
N - Notice of dissolution by a partner.

The fundamental difference between the dissolution of partnership and dissolution of the firm is that when the partnership is dissolved, there is no other dissolution, but when the firm is dissolved, partnership too comes to an end.

Dissolution of Partnership can take the following forms

i. Change in the existing profit sharing ratio
ii. Admission of a Partner
iii. Retirement or Death of a Partner
iv. Insolvency of a partner.
v. Expiry of the term of the partnership.
vi. Completion of the specified venture.
vii. Dissolution by agreement.



i. Dissolution of a partnership firm is taken place in two ways.

a. without the order of the court and
b. By order of the court.

a. Without the order of the court

i. **By agreement or mutual consent**
A firm may be dissolved when all the partners agree to close the affairs of the firm. Just as a partnership is created by contract, it can also be terminated by contract.

ii. **By insolvency of all the partners but one**
If any of the partners adjudged an insolvent (or if all the partners become insolvent) it is necessary to dissolve the firm.

iii. **When the objective becomes illegal**
When the business carried on by the partnership becomes illegal, the partnership firm is automatically dissolved.

A success story of Fourrts India Pvt Limited

(Partnership Firm grown into Company)

Fourrts was founded in 1977 with a strong commitment to the society to deliver quality health care. Fourrts with its impressive standing in the Pharma Industry for the last 35 years is committed to excellence in health care. The dedicated approach of Fourrts has made available a range of innovative, value added, evidence based products for the ailing patients. Fourrts head quarters is in Chennai.

Fourrts' products have found immediate acceptance by practicing doctors both in India and Abroad. At present Fourrts products are spread all over India and over more than 40 countries around the world. Fourrts is one of the fast growing pharmaceutical companies in India. Today Fourrts is backed by a dedicated team of over 1500 professionals, who are well trained in every aspect of pharmaceutical Industry.

iv. By notice of dissolution

In the case of partnership at will when any partner gives in writing to all the other partners indicating his intention to dissolve the firm, the firm will be dissolved.

v. On certain contingencies:

Dissolution of partnership itself may involve the dissolution of the firm unless parties agree to continue it otherwise, it will take place.

i. On the expiry of a specified period in case of partnership for a fixed term.
ii. On the completion of a particular adventure for which it has been formed in case of particular partnership.
iii. On the death of a partner.
iv. On the retirement of a partner.
v. On the insolvency of a partner.

In all the above cases if the business is not continued by the remaining partners, dissolution of the firm takes place automatically.

b. Dissolution through court

The court may order dissolution of a firm at a suit of a partner in any of the following circumstances.

a. When a partner becomes insane
b. Permanent incapacity of any partner
c. Misconduct of any partner
d. Breach of agreement which makes the business impracticable
e. Transfer of interest to third person
f. Continued loss
g. When the court finds that it is just and equitable to dissolve the firm

Key Terms

Karta	Mitakshara Law
Dayabhaga Law	Coparceners
Separate Legal Entity	Dissolution

For Future Learning

a) Raman with members of his extended family established a Joint Hindu Family business of Handicrafts. Raman being the head of family controlled the business as 'Karta'. He had authority to take all decisions for the business. Many times, he sold goods for cash without informing other members of the family business. This resulted in lesser profits. He also sold one of the family properties and gave money to his daughter as a wedding gift. What values did karta ignored in the above case?

b) Palani is an Electronics Engineer. He has met two businessmen who wish to enter into a partnership with him for the manufacture of tape-recorders. They are prepared to make the investment and offer a fourth share in profits to Palani. Would you have any special words of advice for Palani?

For own thinking

i. Write any 2 HUF run Hospitals in your nearest place.

ii. How will you run a HUF for export business?

iii. How will you run a HUF Bus operating business?

iv. How will you organise a partnership business with your friends according to a law?

v. Name a Partnership firm in your town (Nearest).

Case Study

a) A father had self acquired agricultural land. He transferred the said land in the name of his three sons. The revenue records reflect the names of the three sons with 1/3rd share against each name. Father died recently. However physical partition of the said land amongst the three brothers has not been done as they have mutually decided against it. Eldest son has started managing the land since fathers demise. Is the land in question ancestral property of the three brothers ? Can the three brothers claim to a HUF? If yes, then since when are they HUF – after fathers demise or since the date land transferred in their names?

b) Draw a family tree diagram as you think. Just imagine you are running a business under the Joint Hindu Family system.

Exercise

I. Choose the Correct Answer

1. **The firm of Hindu Undivided Family is managed by whom?**

   a. Owner

   b. Karta

   c. Manager

   d. Partner

2. **In the firm of Hindu Undivided Family, how one gets the membership?**

   a. By Agreement

   b. By Birth

   c. By Investing Capital

   d. By Managing

3. **The members in the joint hindu family are called ____________**

   a. Karta

   b. coparceners

   c. generations

   d. partners

4. **'Only the male members in the family get the right of inheritance by birth' as ____________**

   a. Hindu law

   b. Mitakshara Law

   c. Dayabhaga law

   d. None of these

5. **A partnership is formed by _______**

   a. agreement

   b. relationship among persons

   c. the direction of government

   d. Friendship

Answers:

1. b 2. b 3. b
4. b 5. a

II. Very Short Answer Questions

1. Who is called KARTA?
2. What are the two schools of Hindu law?
3. Who is called a Partner?
4. Who is a Sleeping partner?
5. How many types of Dissolution?

III. Short Answer Questions

1. Write any three features of HUF.
2. What is the minimum and maximum number of members in the partnership concern?
3. What is the meaning of Partnership Deed?

IV. Long Answer Questions

1. What are the contents of Partnership Deed? (any 5)
2. Explain the types of dissolution of partnership firm. (any 5)
3. Write the procedure for Registration of a Firm. (any 5)

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UNIT II FORMS OF BUSINESS ORGANISATION

CHAPTER 6 JOINT STOCK COMPANY

Learning Objectives

To enable the students to understand

i. the meaning of Joint Stock Company

ii. the characteristics, advantages, disadvantages

iii. the types of companies

iv. the Memorandum of Association and its contents

v. the Articles of Association and its contents

vi. the Prospectus and its contents

6.01 Meaning and Definition of a Company

A joint stock company is a distinct type of business organisation evolved to overcome the limitations of sole trader and partnership concerns. The advancement in science and technology and the impact of industrial revolution have all necessitated a large amount of capital investment and highly sophisticated managerial skill for running a large-scale industry. Partnership with limitations of its capital and managerial ability and with the added risk of unlimited liability has been found unsuitable for running a large-scale industry in modern times. Therefore joint stock company form of organisation came into existence.

The joint stock companies in India are governed by The Companies Act 2013 (earlier one was, The Companies Act 1956). The new Act has been divided into 29 chapters with 470 sections.

The Act came into force on 12 September 2013 with few changes like earlier private companies maximum number of members was 50 and now it will be 200. A new class of company is of "One Person Company" is included in this Act that will be a private limited company.

Definition

"A company is an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit and loss (as the case may be) arising there from."

- *Lord Lindley*

"A company is an artificial person created by law having a separate entity with a perpetual succession and a common seal".

- *Sec 2 of Companies Act 2013*

Characteristics

A company as an entity has many distinct features which together make it a unique organization. The essential characteristics of a company are as follows:

i. Separate Legal Entity

Under Incorporation a company becomes a separate legal entity as compared to its members. The company is distinct and different from its members. It has its own seal and its own name, its assets and liabilities are separate and distinct from those of its members. It is capable of owning property, incurring debt, and borrowing money, employing people, having a bank account, entering into contracts and suing and being sued separately. In short, it is considered as an artificial person created by law.

ii. Limited Liability

The liability of the members of the company is limited to contribution to the assets of the company upto the face value of shares held by him. A member is liable to pay only the uncalled money due on shares held by him. If the assets of the company are not sufficient to pay liabilities, the personal properties of the shareholders are not held responsible.

iii. Perpetual Succession

A company does not cease to exist unless it is specifically wound up or the task for which it was formed has been completed. Membership of a company may keep on changing from time to time but that does not affect life of the company. A company is created by law and it can be windup only through legal process.

Formation of a Company

DO YOU KNOW?

Highlights of Companies Act, 2013

- The Act, of 2013 has 470 sections as against 658 Sections in the Companies Act, 1956
- The entire Act has been divided into 29 chapters.
- Many new chapters have been introduced such as Registered Valuers (ch.17); Government companies (ch. 23); Companies to furnish information or statistics (ch. 25); Nidhis (ch. 26); National Company Law Tribunal & Appellate Tribunal (ch. 27); Special Courts (ch. 28).
- The Act is forward looking in its approach which empowers the Central Government to make rules,etc. through delegated legislation (section 469 and others).
- The Companies Act, 2013 is the result of detailed consultative process adopted by the Government

iv Separate Property

A company is a distinct legal entity. A member cannot claim to be owner of the company's property during the existence of the company.

v. Transferability of Shares

Shares in a company are freely transferable. When a member transfers his shares to another person, the transferee steps into the shoes of the transferor and acquires all the rights of the transferor in respect of those shares. There are restrictions in the transferability of shares in case of private companies.

vi. Common Seal

A company is an artificial person and does not have a physical presence. Thus, it acts through its Board of Directors for carrying out its activities and entering into various agreements. Such contracts must be under the seal of the company. The common seal is the official signature of the company. The name of the company must be engraved on the common seal. Any document not bearing the seal of the company may not be accepted as authentic and may not have any legal force.

vii. Capacity to Sue and being sued

A company can sue or be sued in its own name as distinct from its members.

viii. Separate Management

A company is administered and managed by its managerial personnel i.e. the Board of Directors. The shareholders are simply the holders of the shares in the company and need not necessarily the managers of the company.

ix. One Share-One Vote

The principle of voting in a company is one share-one vote i.e. if a person has 10 shares, he has 10 votes in the company. This is in direct distinction to the voting principle of a co-operative society where the "One Member - One Vote" principle applies i.e. irrespective of the number of shares held, one member has only one vote.

Advantages

A joint stock company has many advantages. These are given below:

i. Large Capital

A company can secure large capital compared to a sole trader or partnership. Large amount of capital is necessary for conducting business on a large scale. For e.g. Reliance has invested more than ₹25,000 crore in its telecom venture. Raising such huge amount of funds would be utter impossible in a sole-tradership or partnership.

ii. Limited Liability

The liability of a shareholder is limited. In the case of a company limited by guarantee, his liability is restricted to the amount that he has guaranteed to contribute in the event of winding up of the company.

iii. Transferability of Shares

Transaction of Shares between two individuals is easy. So there is liquidity of investment. Any shareholder can easily convert his shares into money by selling his shares.

iv. Perpetual Succession

A company has perpetual or continuous existence. Members may go or new members may come in, but the company continues to exist. This ensures continuity in operations and the company can undertake long term investments.

v. Promotion of Saving and Investment Habit

Joint stock company system encourages people to save. Even small amount can be used for the purchase of shares. A person can buy even one share of a company.

vi. Risk Bearing Capacity

The loss of the company is distributed over a large number of shareholders. So each shareholder bears a very little amount of loss. Hence the company form of organization has risk bearing capacity.

vii. Economies of Large-scale Operation

A joint stock company can undertake business on large scale. As a result it can derive all the advantages of large scale production. For e.g. Hero Moto Corp Ltd. 2015, the world's largest seller of two-wheelers, manufactures motorbikes on a large scale and is able to enjoy cost efficiency.

Example of Limited liability

Shyam is a share holder in a company holding 500 shares of ₹10 each, on which he has already paid ₹7 per share. In the event of losses or company's failure to pay debts , Shyam is liable to pay only ₹1,500. (i.e.,the unpaid amount of ₹3 on 500 shares)

viii. Economic Development

Joint stock company system has been responsible for the rapid growth of industries and trade in many countries. Since Joint Stock Companies have large financial resources, they are able to undertake large scale production, satisfy the needs of more number of consumers, create large scale employment opportunities, promote balanced regional development and contribute substantially to the government by way of taxes.

Disadvantages

The following are the disadvantages of company form of organization

i. Costly and difficult to form

Number of legal formalities must be observed in the formation of the company. To observe these legal formalities, promoters have to spend much time and money.

ii. Scope for dishonest and unscrupulous management

The directors manage the company with the help of paid officers. If the directors are dishonest, they may make personal gain at the expense of the company. They may misuse their power and position.

iii. Management oligarchy

A few rich persons may secure control over the affairs of the company. Thus, the management of a joint stock company might become oligarchic in character. (Oligarchy means a small group of people havimg control)

iv. Speculation

A few individuals may corner the shares to gain control over the company.

v. Lack of interest

The officers of the company do not have incentive to work hard. They are not usually inclined to take risks. They lack initiative.

vi. Lack of good labour relations

In sole trading business personal supervision is possible. But in company form of organization there is lack of personal contact between owners and workers. As a result, there is scope for more industrial disputes in a company form of organization.

vii. High taxation

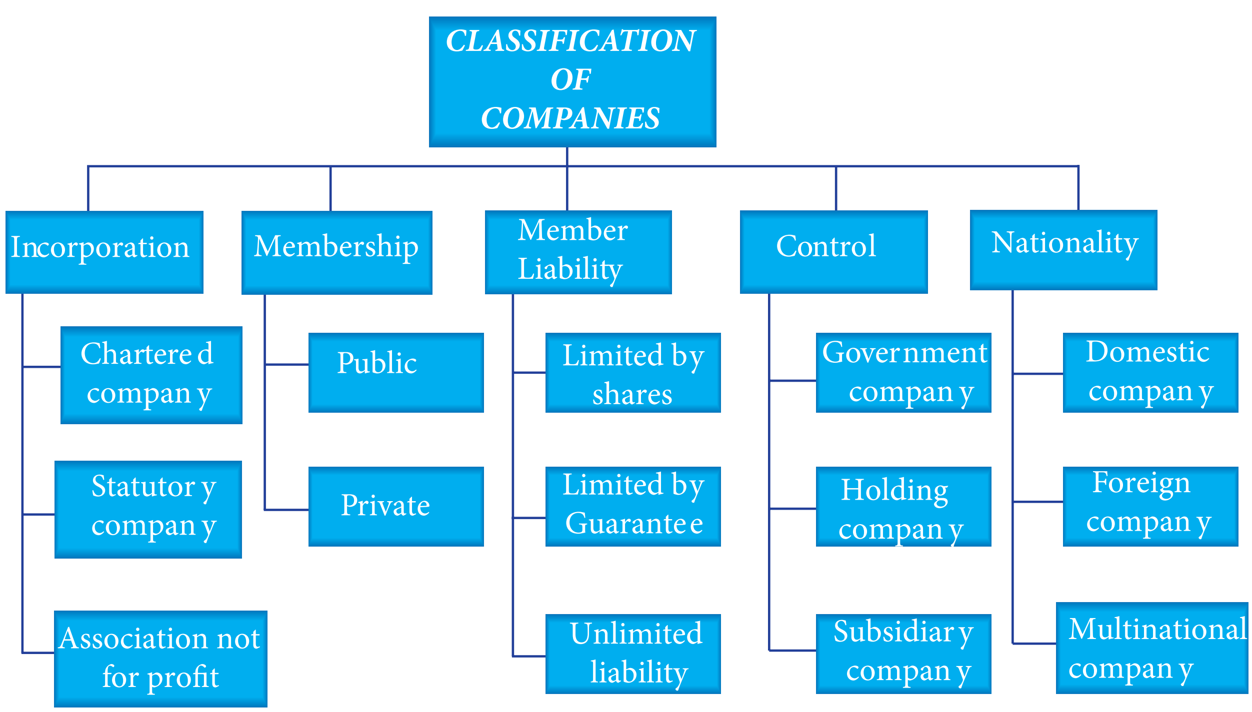
Joint stock companies have to pay tax at higher rates compared to other forms of organizations.

6.02 Types of Companies

1. Classification of Companies on the Basis of Incorporation

a. Chartered Companies

Chartered companies are established by the King or Queen of a country. Powers and privileges of chartered company are specified in the charter. Power to cancel the charter is vested with King/Queen. Examples: East Indian Company, Bank of England, Hudson's Bay Company. The Companies Act does not apply to them. Such companies cannot be started in India.



b. Statutory Companies

Companies are established by a Special Act made in Parliament/State Assembly. Constitution of company is specified in the Memorandum of Association (MOA). Rules relating to day-to-day management of statutory companies are specified in the Articles of Association (AOA). Audit of statutory company is conducted by Comptroller and Auditor General of India (CAGI). The report of CAGI is placed in Parliament/State Assemblies concerned. Examples: Food Corporation of India, LIC, GIC, RBI, SBI, IDBI. Statutory companies enjoy autonomous status. It need not use the word 'Limited' next to its name.

c. Association Not for Profit

According to Section 8 of the Companies Act (2013), the Central Government may, by license, grant that an association may be registered as a company with limited liability, without using the words 'limited' or 'private limited' as part of its name. The license will be granted only in the case of 'association not for profit'. In other words, the Central Government will grant the license only if it is satisfied that:

(i) The association about to be formed as a limited company aims at the promotion of Sports, Commerce, Art, Science, Religion, Charity or any other useful object.

(ii) It intends to apply its profits, if any, for promoting its objects.

(iii) It prohibits the payment of dividend to its members.

Such companies may be public or private companies and may or may not have share capital.

2. Classification of Companies on the basis of Membership

a. Private Company

Private limited company is a type of company which is formed with minimum two shareholders and two directors, The minimum requirement with respect to authorised or paid up capital of ₹1,00,000 has been omitted by The Companies (Amendment) Act, 2015 w.e.f. 29th of May, 2015. Another crucial condition of a private limited company is that it by its articles of association restricts the right to transfer its shares & also prohibits any invitation to the public to subscribe for any securities of the company. Maximum of 200 persons can become shareholders in a private company. The name of private company should be suffixed with pvt ltd or (p) ltd. Ex. Scientific publishing services private Limited, Chennai. A private Limited company can be formed in three variations.

(a) as a private limited company; (b) As a small private limited company; (c) As a One Person Company (OPC).

b. Public Company

Public Company means a company which is not a private company. A public company may be said to be an association which

(i) consists of at least 7 members.

(ii) has a minimum paid-up capital of ₹5,00,000 or such higher paid up capital as may be prescribed.

(iii) is a subsidiary of a company which is not a private company.

(iv) does not restrict the right to transfer its shares.

(v) does not prohibit any invitation to subscribe for any shares or debentures of the company.

(vi) does not prohibit any invitation or acceptance of deposits. (The name of public company should be suffixed with ltd. Ex.National Aluminium company Limited, Chennai)

3. Classification of Companies on the basis of Liability

a. Company Limited by Shares

A company limited by shares is a company in which the liability of its members is limited by its Memorandum to the amount (if any) unpaid on the shares respectively held by them. The companies limited by shares may be either public companies or private companies. If a member has paid the full amount of shares, then his liability shall be nil.

Thus two main features of a company limited by shares are as follows:

(i) The liability of its members is limited to the amount (if any) remaining unpaid on the shares held by them.

(ii) Such liability can be enforced either during the lifetime of the company or during the winding up of the company.

b. Company Limited by Guarantee

A company limited by guarantee is a company in which the liability of its members is limited by its Memorandum to such an amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up. Such companies are generally formed for the promotion of Commerce, Art, Science, Religion, Charity or any other useful object. The companies limited by guarantee may be either private companies or public companies.

c. Unlimited Company

An unlimited company is a company in which the liability of its members is not limited by its Memorandum. In other words, the liability of members is unlimited i.e., there is no limit on the liability of members. The members of such companies may be required to pay company's losses from their personal property. Because such companies have separate legal entity, its creditors cannot file a suit against the members directly. The creditors will have to apply to the court for the winding up of the company and then the liquidator will direct the members to contribute to the assets of the company to pay off its liabilities.

4. Classification of Companies on the Basis of Control

a. Government Companies

A public enterprise incorporated under the Indian Companies Act, 1956 is called a government company. These companies are owned and managed by the central or the state government. Section 617 of the Companies Act, 1956 defines "Government Companies" as any company in which not less than 51% of the [paid-up share capital] is held by.

1. The Central Government; or
2. Any State Government or Governments; or
3. Partly by the Central Government and partly by one or more State Governments.

A subsidiary of a Government company shall also be treated as a Government company. These companies are registered as private limited companies though their management and their control vest with the government. This is a type of organization where both the government and private individuals are shareholders. Sometimes these companies are called as a mixed ownership company.

Examples: Steel Authority of India, Indian Oil Corporation, Oil and Natural Gas Corporation, Bharath Heavy Electricals.

b. Holding Companies

As per Section 2(87) "subsidiary company" or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

c. Subsidiary Companies

"Subsidiary company" or "Subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company.

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Examples: H Ltd., holds more than 50% of the equity share capital of S Ltd. Now H Ltd., is the holding company of S Ltd., and S Ltd., is the subsidiary of H Ltd.

5. Classification of Companies on the Basis of Nationality

a. Domestic Companies

A company which cannot be termed as foreign company under the provision of the Companies Act should be regarded as a domestic company.

b. Foreign Companies

A foreign company means a company which is incorporated in a country outside India under the law of that country. After the establishment of business in India, the following documents must be filed with the Registrar of Companies within 30 days from the date of establishment.

(i) A certified copy of the charter or statutes under which the company is incorporated, or the Memorandum and articles of the company translated into English.

(ii) The full address of the registered office of the company.

(iii) A list of directors and secretary of the company.

(iv) The name and address of any person resident of India who is authorised to accept, on behalf of the company, service of legal process and any notice served on the company.

(v) The full address of the company's principal place of business in India.

c. Multi National Companies

A Multi National Company (MNC) is a huge industrial organisation which,

(i) Operates in more than one country

(ii) Carries out production, marketing and research activities on international Scale in those countries.

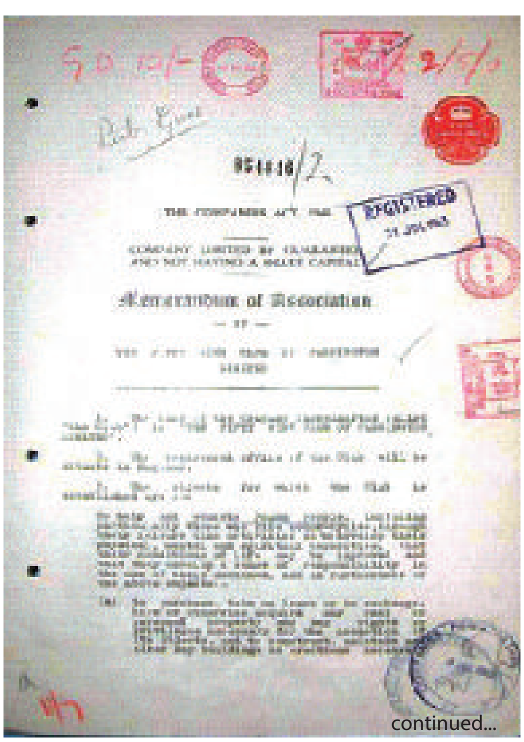
(iii) Seeks to maximise profits world over.

A domestic company or a foreign company can be a MNC.

Examples: Microsoft Corporation, Nokia Corporation, Nestle, Coca-Cola, International Business Machine, Pepsico, Sony Corporation.

6.03 Memorandum of Association

A Memorandum of Association (MOA) is a legal document prepared in the formation and registration process of a limited liability



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company to define its relationship with shareholders. It reveals what powers it has and what activities the company is permitted to undertake. Any act of the company outside the scope outlined in its memorandum is said to be ultra virus and is not binding on it. It is the constitution of the company in its relation to the outside world. It is a public document and any person dealing with the company is presumed to have sufficient knowledge of it. It is the primary document of a company.

Contents

1. Name Clause

The name clause requires to state the legal and recognized name of the company. The company name is allow to be registered if it does not bear any similarities with the name of an existing company. companies only.

2. Situation Clause

The registered office clause requires to show the physical location of the registered office of the company. It is required to keep all the company registers in this office. The registered office should be established prior to commencing business activities.

3. Objective Clause

The objective clause requires to summarize the main objectives for establishing the company with reference to the requirements for shareholding and use of financial resources. It is required to state the ancillary objectives; that is, those objectives that are required to facilitate the achievement of the main objectives. The objectives should be free of any provisions or declarations that contravene laws or public good.

4. Liability Clause

The liability clause requires to state the extent to which shareholders of the company are liable to the debt obligations of the company in the event of the company dissolving. There are companies limited by shares and limited by guarantee.

5. Capital Clause

The capital clause requires to state the company's authorized share capital, the different categories of shares and the nominal value (the minimum value per share) of the shares. It is also required to list the company's assets under this clause.

6. Association Clause

The association clause confirms that shareholders bound by the MOA are willingly associating and forming a company. It is required seven members to sign an MOA for a public company and not less than two people for a MOA of a private company. The sighing must be done in the presence of witness who must also append his signature.

6.04 Articles of Association

The Articles of Association (AOA) is a document that contains the purpose of the company as well as the duties and responsibilities of its members. It is an important document which needs to be filed with the Registrar of Companies. These are the bylaws of a company that defines the mode and manner in which the company's business is to be carried on. In the Companies Act, Table A Prescribes model for the articles of the companies. Table A is a document containing rules and regulations for the internal management of a company. A company which does not have separate AOA may adopt Table A.

Contents

(i) Amount of shares, capital, value and type of shares

(ii) Rights of each class of shareholders regarding voting, dividend, return of capital

(iii) Rules regarding issue of shares and debentures

(iv) Procedures as well as regulations in respect of making calls on shares.

(v) Manner of transfer of shares

(vi) Declaration of dividends

(vii) Borrowing powers of the company

(viii) Rules regarding the appointment, remuneration, removal of directors

(ix) Procedure for conducting proxy, quorum, meetings etc.,

(x) Procedures concerning keeping of books and audits

(xi) Seal of the company

(xii) Procedures regarding the winding up of the company.

6.05 Prospectus

According to Section 2(36) of the Companies Act, any document inviting the public to buy its shares or debentures comes under the definition of prospectus. It also applies to advertisements inviting deposits from the public.

Contents

A prospectus is "the only window through which a prospective investor can look into the soundness of a company's venture". Hence it must specify at least the following matters as per Schedule II:

(i) The prospectus contains the main objectives of the company, the name and addresses of the signatories of the Memorandum of Association and the number of shares held by them.

(ii) The name, addresses and occupation of directors and managing directors.

(iii) The number and classes of shares and debentures issued.

(iv) The qualification share of directors and the interest of directors for the promotion of company.

(v) The number, description and the document of shares or debentures which within the two preceding years have been agreed to be issued other than cash.

(vi) The name and addresses of the vendors of any property acquired by the company and the amount paid or to be paid.

(vii) Particulars about the directors, secretaries and the treasures and their remuneration.

(viii) The amount for the minimum subscription.

(ix) If the company carrying on business, the length of time of such businesses.

(x) The estimated amount of preliminary expenses.

(xi) Name and address of the auditors, bankers and solicitors of the company.

(xii) Time and place where copies of balance sheets, profits and loss account and the auditor's report may be inspected.

(xiii) The auditor's report so submitted must deal with the profit and loss of the company for each year of five financial years immediately preceding the issue of prospectus.

(xiv) If any profit or reserve has been capitalized, the particulars of such capitalization will be stated in the prospectus.

Key Terms

Guarantee
Memorandum of Association
Prospectus
Common seal
Perpetual succession
Artificial person

For Own Thinking

1. Name any 2 Government owned Joint Stock Company.
2. Name any 2 Joint stock company with private ownership.
3. Name any 2 Private ownership with Foreign participants.

For Future Learning

Collect advertisements of three different companies inviting the public to subscribe their shares. Compare their contents regarding following points

Articles	Company A	Company B	Company C
Name			
Objectives			
Types of shares to be subscribed			
Total amount of issue			
The issue price of each share			

Case Study

Case 1: Ashok is an industrial designer by training. He had the opportunity to learn the technology of fibre glass manufacture while he was in Germany for his training. He plans to set up a plant for the manufacture of fibre glass in India and is able to interest some financiers and technologists. It is estimated that the initial investment in the plant will be of the order of ₹50 lakhs. Ashok and others decide to set up a company for the purpose.

Should they set up a public limited company for the purpose? If so, how should they go about it? If not, what alternative would you suggest? What formalities will be required of Ashok and his associates if they choose the alternative form of organization suggested by you?

Case 2: Collect any 10 items of daily use (Packed items) and list the names of the companies manufacturing those items. Classify those companies as public and private limited companies. Which of them are Multinational Companies?

6J1HO

Exercise

I. Choose the Correct Answer

1. **The relationship between outsiders and the company is defined in ______**

   a) Prospectus

   b) Articles of Association

   c) Memorandum of Association

   d) Certificate of Incorporation

2. **Table A of the Companies Act is a ______**

   a) Model minutes book

   b) Model form of Balance Sheet

   c) Model of AOA

   d) Model of MOA

3. **Which of the following is created by a Special Act of Parliament or in State Assemblies?**

   a) Chartered company

   b) Foreign company

   c) Government company

   d) Statutory company

4. **The Board of directors of a company is elected by _________**

   a) Creditors

   b) Debtors

   c) Debenture holders

   d) Share holders (members)

5. **Companies established as a result of a charter granted by the King or Queen of a country is called _________**

   a) Chartered companies

   b) Statutory companies

   c) Registered companies

   d) Foreign companies

Answers

1. c 2. c 3. d 4. d 5. a

II. Very Short Answer Questions

1. What are the different types of companies?
2. Define a Company.
3. What is meant by Limited liability?
4. Explain any two characteristics of a company.
5. What is meant by Chartered Company?

III. Short Answer Questions

1. What are the advantages of Companies? (any 3)
2. What is meant by Government Company?
3. What is meant by Foreign Company?

IV. Long Answer Questions

1. What are the contents of Memorandum of Association? (any 5)
2. What are the contents of Articles of Assocition? (any 5)
3. What is meant by Multi National Company?

Reference

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UNIT II FORMS OF BUSINESS ORGANISATION

CHAPTER 7 COOPERATIVE ORGANISATION

Learning Objectives

To enable the students to understand

i. the meaning of Cooperatives,

ii. the characteristics, advantages and disadvantages,

iii. the principles of Cooperatives,

iv. the types of Cooperatives.

7.01 Meaning and Definition

A cooperative is a form of business organisation which is owned and controlled by the people who use its products, supplies or services. Although cooperatives vary in type and membership size, all were formed to meet the specific objectives of members, and are structured to adapt to member's changing needs.

DO YOU KNOW?

In 1844,in England, 28weavers (Rochdale Pioneers) started the first ever Cooperative Society.

Cooperatives are formed by individuals who coordinate among themselves (horizontal coordination) to achieve vertical integration in their business activities.

Cooperatives were useful for promoting the interests of the less powerful members of society. Farmers, producers, workers, and consumers found that they could accomplish more collectively than they could individually.

Although people have been working together for their mutual benefit throughout human history, the cooperative form of business organization began during the Industrial Revolution. At first, the cooperative movement was started by Robert Owen, in the year 1844. He formed a consumer's cooperative society in England with 28 workers as members, called "Rochdale Society of Equitable Pioneers". This gradually led to world-wide movement of organising, cooperatives in various fields of economic activity such as credit, farming, marketing, processing, housing, transport, insurance, fisheries, poultry, dairying, etc., The main object of the cooperative movement was to bring solace and comfort to the needy persons by pursuing common economic interests through cooperative trading. Profit is not a main objective.

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Definition

Examples of a Cooperative Society:

Cooperation is a form of organization in which persons voluntarily associate together as human beings on the basis of equality for the promotion of the economic interests of themselves.

- H.Calvert

Cooperation is "better farming, better business and better living"

- Sir Horace Plunkett

(i) Indian Coffee House
(ii) Mother Dairy
(iii) Shri Mahila Griha Udyog Lijjat Papad
(iv) Indian Farmers Fertilizers Cooperative Limited
(v) The Indian Airlines (Cargo) C.G.H.S.Ltd.

7.02 Principles of Cooperation

i. Voluntary and Open Membership

Cooperatives are voluntary organizations, open to all people able to use its services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

ii. Democratic Member Control

Cooperatives are democratic organizations controlled by their members—those who buy the goods or use the services of the cooperative—who actively participate in setting policies and making decisions.

iii. Member's Economic Participation

Members contribute equally to, and democratically control, the capital of the cooperative. This benefits members in proportion to the business they conduct with the cooperative rather than on the capital invested.

iv. Autonomy and Independence

Cooperatives are autonomous, self-help organizations controlled by their members. If the co-operative organisation enters into agreements with other organizations or raises capital from external sources, it is done so based on terms that ensure democratic control by the members and maintains the cooperative's autonomy.

v. Education, Training, and Information

Cooperatives provide education and training for members, elected representatives, managers and employees so they can contribute effectively to the development of their cooperative. Members also inform the general public about the nature and benefits of cooperatives.

vi. Cooperation among Cooperatives

Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures.

vii. Concern for Community

While focusing on member needs, cooperatives work for the sustainable development of communities through policies and programs accepted by the members.

DO YOU KNOW?

The flag is a common symbol of the seven color rainbow of the International Co-operation Movement. In 1922, the International Cooperative Alliance (ICA) organized the International Co-operative logo and a flag on the first co-operative day of July 1923 in the city of Eszhen, Germany.

7.03 Features of Cooperatives

The following are some of the important principles of co-operative societies.

i. Voluntary Membership

Any person can become the member of the society and can leave it any time.

ii. Equal Rights

Each member of the society has an equal right to vote and ownership. Each shareholder has one vote.

iii. Democracy

The principle of democracy is adopted while making the decisions. The decision of the majority is honored.

iv. Honesty

It is the basic principle of this society. Its members should be honest. Selfish people can not run the business of cooperative society.

v. Mutual Confidence

The foundation of Cooperative society is laid on mutual confidence. Members of the society should trust each other and work like a team.

vi. Welfare Main Objective

Its main objective is to provide goods and services to its members at lower price.

vii. Cash Payment

Credit team is prohibited and goods are supplied to its members on cash payment.

viii. Economy

The member of the society should act upon the principle of economy. They should not misuse capital of the society and always keep in view best interest of the society.

ix. Distribution of Profit

The profit can be distributed among the members according the cooperative act. One fourth (1/4) of the profit can be kept in reserve. Then (10%) of the profit can be used for providing facilities to the members.

x. Self Service

All the business activities are conducted by the members themselves. All are the owner and all are the consumers. So self service rule is employed in the organization.

7.04 Advantages and Disadvantages

Advantages

The following are some of the important advantages of co-operative societies.

i. Voluntary organization

The membership of a cooperative society is open to all. Any person with common interest can become a member. The membership fee is kept low so that everyone would be able to join and benefit from cooperative societies. At the same time, any member who wants to leave the society is free to do so. There are no entry or exit barriers.

ii. Easy formation

Cooperatives can be formed much easily when compared to a company. Any 25 members who have attained majority can join together for forming a cooperative society by observing simple legal formalities.

iii. Democracy

A co-operative society is run on the principle of 'one man one vote'. It implies that all members have equal rights in managing the affairs of the enterprise. Members with money power cannot dominate the management by buying majority shares.

iv. Equal distribution of surplus

The surplus generated by the cooperative societies is distributed in an equitable manner among members. Therefore all the members of the cooperative society are benefited. Further the society is also benefited because a sum not exceeding 10 per cent of the surplus can be utilized for promoting the welfare of the locality in which the cooperative is located.

v. Limited liability

The liability of the members in a cooperative society is limited to the extent of their capital contribution. They cannot be personally held liable for the debts of the society.

vi. Separate legal entity

A cooperative society enjoys separate legal entity which is distinct from its members. Therefore its continuance is in no way affected by the death, insanity or insolvency of its members. It enjoys perpetual existence.

vii. Each for all and all for each

Co-operative societies are formed on the basis of self help and mutual help. Therefore members contribute their efforts to promote their common welfare.

viii. Greater identity of interests

It operates in a limited geographical area and there is greater identity of interest among members. Members would be interacting with each other. They can cooperate and manage the activities of the society in a more effective manner.

ix. Government support

The government with a view to promote the growth of cooperative societies extends all support to them. It provides loans at cheap interest rates, provides subsidies etc.

x. Elimination of middlemen

Cooperatives societies can deal directly with the producers and with the ultimate consumers. Therefore they are not dependent on middlemen and can save the profits enjoyed by the middlemen.

xi. Tax concessions

To promote the co-operative movement and also because of the fact that it is a non-profit enterprise, government provides various exemptions and tax concessions.

xii. Rural credit

Co-operative societies have contributed significantly in freeing villagers from money lenders. Earlier, money lenders used to charge high rates of interest and the earnings of the villagers were spent on payment on interest alone.

Co-operatives provide loans at cheaper interest rates and have benefited the rural community. After the establishment of co-operatives, the rural people were able to come out of the grip of money lenders.

Disadvantages

i. Limited funds

Co-operative societies have limited membership and are promoted by the weaker sections. The membership fees collected is low. Therefore the funds available with the co-operatives are limited. The principle of one-man one-vote and limited dividends also reduce the enthusiasm of members.

They cannot expand their activities beyond a particular level because of the limited financial resources.

ii. Over reliance on Government funds

Co-operative societies are not able to raise their own resources. Their sources of financing are limited and they depend on government funds. The funding and the amount of funds that would be released by the government are uncertain. Therefore co-operatives are not able to plan their activities in the right manner.

iii. Imposed by Government

In the Western countries, co-operative societies were voluntarily started by the weaker sections. The objective is to improve their economic status and protect themselves from exploitation by businessmen. But in India, the co-operative movement was initiated and established by the government. Wide participation of people is lacking. Therefore the benefit of the co-operatives has still not reached many poorer sections.

iv. Benefit to rural rich

Co-operatives have benefited the rural rich and not the rural poor. The rich people elect themselves to the managing committee and manage the affairs of the co-operatives for their own benefit. The agricultural produce of the small farmers is just sufficient to fulfill the needs of their family. They do not have any surplus to market. The rich farmers with vast tracts of land produce in surplus quantities and the services of co-operatives such as processing, grading, correct weightment and fair prices actually benefit them.

v. Inadequate rural credit

Co-operative societies give loans only for productive purposes and not for personal or family expenses. Therefore the rural poor continue to depend on the money lenders for meeting expenses of marriage, medical care, social commitments etc. Co-operatives have not been successful in freeing the rural poor from the clutches of the money lenders.

vi. Lack of managerial skills

Co-operative societies are managed by the managing committee elected by its members. The members of the managing committee may not have the required qualification, skill or experience. Since it has limited financial resources, its ability to compensate its employees is also limited. Therefore it cannot employ the best talent. Lack of managerial skills results in inefficient management, poor functioning and difficulty in achieving objectives.

vii. Government intervention

Co-operative societies are subject to excessive government regulation which affects their autonomy and flexibility. Adhering to various regulations takes up much of the management's time and effort.

viii. Misuse of funds

If the members of the managing committee are corrupt they can swindle the funds of the co-operative society. Many cooperative societies have faced financial troubles and closed down because of corruption and misuse of funds.

ix. Inefficiencies leading to losses

Co-operative societies operate with limited financial resources. Therefore they cannot recruit the best talent, acquire latest technology or adopt modern management practices. They operate in the traditional mold which may not be suitable in the modern business environment and therefore suffer losses.

x. Lack of secrecy

Maintenance of business secrets is the key for the competitiveness of any business organization. But business secrets cannot be maintained in cooperatives because all members are aware of the activities of the enterprise. Further, reports and accounts have to be submitted to the Registrar of Co-operative Societies. Therefore information relating to activities, revenues, members etc becomes public knowledge.

xi. Conflicts among members

Cooperative societies are based on the principles of co-operation and therefore harmony among members is important. But in practice, there might be internal politics, differences of opinions, quarrels etc. among

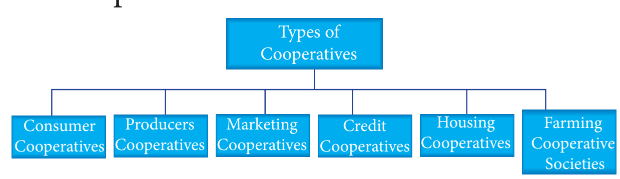
members which may lead to disputes. Such disputes affect the functioning of the co-operative societies.

xii. Limited scope

Co-operative societies cannot be introduced in all industries. Their scope is limited to only certain areas of enterprise. Since the funds available are limited they cannot undertake large scale operations and is not suitable in industries requiring large investments.

7.05 Types of Cooperatives

The Cooperatives can be broadly classified into two viz., Credit Cooperatives and Non- Credit Cooperatives. The credit cooperatives can be further classified into Agricultural credit and non-Agricultural credit coopertives. However for beginners the coopertives are classified as follows.



A. Consumers Cooperatives

Consumer cooperatives are organized by consumers that want to achieve better prices or quality in the goods or services they purchase. In contrast to traditional retail stores or service providers, a consumer cooperative exists to deliver goods or services rather than to maximize profit from selling those goods or services. They also supply essential commodities through Public Distribution System (PDS). Nationally, the most widely used cooperative form is the credit union, with some 90 million members. Credit union assets have grown a hundred-fold in three decades. Credit unions are essentially cooperatives of people that use banking services.

Students' cooperative stores, Cooperative provision stores and supermarkets set up on cooperative societies of India are examples of this type.

B. Producers Cooperatives

Producer cooperatives are established and operated by producers. Producers can decide to work together or as separate entities to help increase marketing possibilities and production efficiency. They are organized to process, market, and distribute their own products. This helps lessen costs and strains in each area with a mutual benefit to each producer.

Example,
Cooperative weavers' societies, Cooperative carpenting units, Cooperative match factories.

C. Marketing Cooperatives

Cooperative marketing societies are associations of small producers formed for the purpose of marketing their produce. The marketing cooperatives perform certain marketing functions such as grading, warehousing, advertising etc., They secure better prices for their members by transporting goods even to distant markets. Advance is also given to members against produce deposited with the society. Thus they are a boon to agriculturists, small producers and artisans, who in the absence of these cooperatives would be forced to sell at low prices to middlemen.

D. Credit Cooperatives

Cooperative credit societies are those formed for the purpose of providing short-term financial help to their members. Agriculturists, artisans, industrial workers, salaried employees, etc., form these credit societies. Being unable to obtain financial accommodation from banks they are at the mercy of money-lenders who charge exorbitant rates of interest. Ending this exploitation and encouraging thrift among members is the objective of these societies. Credit societies may be agricultural credit societies or non-agricultural credit societies.

E. Housing Cooperatives

These cooperative housing societies are meant to provide residential accommodation to their members on ownership basis or on rent. People who intend to build houses of their own join together and form housing societies. These societies advance loans to members, repayable over a period of 15 to 20 years. Housing building societies, on the other hand, construct houses for their members instead of granting loans to them. These are house construction societies which acquire land, construct houses and rent them to members. The member-tenant, however, can own the houses after paying the cost.

F. Cooperative Farming Societies

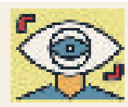
When various farmers in a village pool their land together and agree to treat the pooled piece of land as one big farm for the purpose of cultivation, purchase the necessary inputs for the cultivation, and market the crops jointly, they are assumed to have formed a cooperative farming society. Such a society, for its proper working elects its office bearers on the basis of one member-one-vote.

The office bearers look after the proper cultivation of new farm that emerges after the land of various farmers has been pooled. The ownership of the land still lies with the respective members of the society and they withdraw from the society whenever they so like.

Besides land the farmers also contribute various productive assets as well as their labour for the purpose of cultivations. Whereas they get rent for their land and productive assets, they get wages, for their labour.

Key Terms

Voluntary Association
Voting Rights
Service Motto
Limited capital
Consumers Cooperatives
Marketing Cooperatives
Housing Cooperatives
Credit Cooperatives



For Future Learning

a) A group of mechanical and automobile engineers join hands to set up a Cooperative for assembly of scooters. How can they go about it? What principles would you like them to keep in mind? How can they augment their financial resources and how should they organise the marketing effort?

b) Now a days we all live in High rise flats. These are either constructed by builders or built by group of people as a society. Work in groups and collect information regarding any two cooperative housing societies in your neighbourhood.

Collect information for the following:

Name of the society; Certificate of registration; Process of registration the society had to follow; the manner in which the managing body is elected; what functions do they perform; what kind of legal formalities they need to complete or any other information you may find relevant.

Case Study

Chandru, a trade union activist, lives in a Workers' colony in the city of Chennai. He is a devoted leader for the cause of workers' welfare. For the last many months he has been observing that the local vendors of commodities of daily use have been making huge profits by charging high process from workers. He cannot tolerate all this and thinks of the idea of opening a consumers' cooperative store in the colony. He calls a few elderly workers of the locality, tells them about their exploitation by merchants and discusses with them all his plans to solve the problem. Merchants and discusses with them all his plans to solve the problem. While some of the workers welcome the scheme. Others express their genuine doubts about its feasibility and success. Take the roles of these workers and list out the possible arguments among them.

For Own Thinking

1. List out any 2 Co-operative institutions.
2. Name any 2 district level cooperative organisations.
3. Mention any 3 village level primary cooperatives in your area?

Exercise

I. Choose the Correct Answer:

1. **Membership in a cooperative organization is:**
   a) Not open to all b) Selective
   c) Open to all d) None of them

2. **Cooperative fails because of**
   a) Unlimited membership
   b) Cash trading
   c) Mismanagement
   d) Loss-making

3. **All cooperatives are established with**
   a) Philanthropic motive
   b) Service motive
   c) Profit motive
   d) Reform motive

4. **Consumers Co-operation was first successful in _____**
   a) England b) USA
   c) Swiss d) India

5. **Rochdale society of equitable pioneers was started by ____**
   a) Robert owen b) H.C.Calvert
   c) Talmaki d) Lambert

Answers

1. c 2. c 3. b 4. a 5. a

II. Very Short Answer Questions

1. What do you mean by cooperative organization?
2. Define Cooperatives.
3. What is Credit cooperatives?
4. Who are Rochadale Pioneers?

III. Short Answer Questions

1. What are the disadvantages of Cooperatives? (any 3)
2. Write a note on Housing cooperatives.
3. What is meant by Producers cooperative society?

IV. Long Answer Questions

1. What are the principles of cooperatives? (any 5)
2. What are the advantages of cooperative society? (any 5)
3. What are the types of cooperative society. (any 5)

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2. Krishnamoorthy,O.R, Fundamental of Cooperation
3. https://accountlearning.com

UNIT II FORMS OF BUSINESS ORGANISATION

CHAPTER 8 MULTI NATIONAL CORPORATIONS (MNCs)

Learning Objectives

To enable the students to understand

i. the meaning of a Multi National Corporations,

ii. the advantages, disadvantages,

iii. the examples of MNC

8.01 Meaning and Definition

A multinational company is one which is incorporated in one country (called the home country); but whose operations extend beyond the home country and which carries on business in other countries (called the host countries) in addition to the home country.

It must be emphasized that the headquarters of a multinational company are located in the home country.

A multinational corporation is known by various names such as: global enterprise, international enterprise, world enterprise, transnational corporation etc.

Definition of MNC

"A multinational corporation owns and manages business in two or more countries."

- Neil H.Jacoby

"MNC is defined to be an enterprise operating in several countries but managed from one country"

Oligopoly: It is a market condition where there are very few sellers in the same product line.

Global enterprises are the business organisations which operate in more than one country. Since they operate in more than one nation they are also called as Multi National Companies.

8.02 Advantages and Disadvantages

Advantages

i. Low Cost Labour

MNC set up their facilities in low cost countries and produce goods/service at lower cost. It gains cost advantage and sells its products and services of good quality at low cost. This is not available to smaller companies which operate at regional level.

ii. Quality Products

The resource, experience and expertise of MNCs in the sphere of research and development enables the host country to establish its research and development system which helps it in producing quality goods and services at least possible cost.

iii. Proper Use of Idle Resources

Because of their advanced technical knowledge, MNCs are in a position to properly utilise idle physical and human resources of the host country. This results in an increase in the National Income of the host country.

iv. Improvement in Balance of Payment Position

MNCs help the host countries to increase their exports. As such, they help the host country to improve upon its Balance of Payment position.

v. Technical Development

MNCs carry the advantages of technical development 10 host countries. In fact, MNCs are a vehicle for transference of technical development from one country to another. Because of MNCs poor host countries also begin to develop technically.

vi. Managerial Development

MNCs employ latest management techniques. People employed by MNCs do a lot of research in management. In a way, they help to professionalize management along latest lines of management theory and practice. This leads to managerial development in host countries.

vii. End of Local Monopolies

The entry of MNCs leads to competition in the host countries. Local monopolies of host countries either start improving their products or reduce their prices. Thus MNCs put an end to exploitative trade practices of local monopolists. As a matter of fact, MNCs compel domestic companies to improve their efficiency and quality.

In India, many Indian companies acquired ISO-9000 quality certificates, due to fear of competition posed by MNCs.

viii. Improvement in Standard of Living

By providing super quality products and services, MNCs help to improve the standard of living of people of host countries.

ix. Promotion of international brotherhood and culture

MNCs integrate economies of various nations with the world economy. Through their international dealings, MNCs promote international brotherhood and culture; and pave way for world peace and prosperity.

Disadvantages

i. Danger for Domestic Industries

MNCs, because of their vast economic power, pose a danger to domestic industries; which are still in the process of development. Domestic industries cannot face challenges posed by MNCs. Many domestic industries have to wind up, as a result of threat from MNCs. Thus MNCs give a setback to the economic growth of host countries.

ii. Transfer of Outdated Technology

Where MNCs transfer outdated technology to host nation, it serves no purpose.

iii. No Benefit to Poor People

MNCs produce only those things, which are used by the rich. Therefore, poor people of host countries do not get, generally, any benefit, out of MNCs.

iv. Danger to Independence

Initially MNCs help the Government of the host country, in a number of ways; and then gradually start interfering in the political affairs of the host country. There is, then, an implicit danger to the independence of the host country, in the long-run.

v. Deprivation of Job Opportunity of Local People

MNCs may not generate job opportunities to the people of home country.

vi. Misuse of Mighty Status

MNCs are powerful economic entities. They can afford to bear losses for a long while, in the hope of earning huge profits-once they have ended local competition and achieved monopoly. This may be the dirty marketing strategy of MNCs to wipe off local competitors from the host country.

vii. Careless Exploitation of Natural Resources

MNCs tend to use the natural resources of the host country carelessly. They cause rapid depletion of some of the non-renewable natural resources of the host country. In this way, MNCs cause a permanent damage to the economic development of the host country.

viii. Selfish Promotion of Alien Culture

MNCs tend to promote alien culture in host country to sell their products. They make people forget about their own cultural heritage. In India, e.g. MNCs have created a taste for synthetic food, soft drinks etc. This promotion of foreign culture by MNCs is injurious to the health of people also.

ix. Neglect of Industrial and Economic Growth of Home Country

An investment in host countries is more profitable, MNCs may neglect home countries industrial and economic development.

8.03 Examples of MNCs

List of Indian subsidiary companies of Foreign MNCs

Foreign Multinational	Indian Affiliate / Subsidiary	Company Logo
Bata Corporation	Bata India	Bata India
Colgate Palmolive	Colgate India	COLGATE-PALMOLIVE
Sony Corporation	Sony India	SONY
Suzuki	Maruthi Suzuki	MARUTI SUZUKI
Timex	Timex watches	TIMEX

List of Indian Multinational Companies and their Logo (Do you know?)

Company	Headquarter	Company Logo
Micromax Informatics	Gurgaon	
Hero Motocorp	New Delhi	
Bajaj	Pune	
Britannia	Bengaluru	
TVS	Chennai	
TATA	Mumbai	
INFOSYS	Bengaluru	

Key Terms

Oligopoly
Global Enterprises
Exploitation
Host Country
Domestic industry

For Own Thinking

1. Name any 2 Indian Multinational Companies in abroad?
2. Name any 2 Foreign Companies in India?

For Future Learning

Multinational companies establish themselves in developing countries to enjoy huge profits by selling consumer goods or luxury items. They start business by offering wide variety of goods at prices cheaper than local retailers offer. But once they are established they increase prices.

a. State the values the government of a developing country ignores while allowing MNCs to establish in their country.

b. What value do the MNCs violate?

Case Study

Public enterprises are established to achieve the goal of economic and social development of the country. They are managed and controlled by Central or State Governments through ministers or government officials. Many times their poor performance i influences the policy formulation and running of the enterprise into loss. Even the big business houses use their influence and get the policies formulated in their favour. State the role of ministers or government to frame the policies for the success of public enterprises.

Exercise

I. Choose the Correct Answer

1. A Multinational Corporation can be defined as a firm which

a) is beyond the control of any government

b) is one of the top 200 firms in the world

c) owns companies in more than one country

d) All the above

2. Centralised control in MNC's implies control exercised by

a) Branches

b) Subsidiaries

c) Headquarters

d) Parliament

3. Enterprises operating in several countries but managed from one country is termed as ___________

a) Government company

b) Multinational Company

c) Private company

d) Joint Venture

4. Dispersal of decision making power to branches/affiliates/subsidiaries by head office represents _________

a) Centralisation b) Decentralisation

c) Power d) Integration

5. Coca-Cola company is an example of ___________

a) MNC b) Government company

c) Joint Venture d) Public company

Answers

1. c 2. c 3. b 4. b 5. a

II. Very Short Answer Questions

1. Define Multinational Company.
2. Write any two advantages of MNC's.
3. Give two examples of MNC's.

III. Short Answer Questions

1. Name the type of business enterprises which operates in more than one country.
2. Write any three Indian MNC's.

III. Long Answer Questions

1. What are the advantages of MNC's? (any 5)
2. What are the disadvantages of MNC's? (any 5)

Reference

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2. Shukula, M.C. Business Organisation.

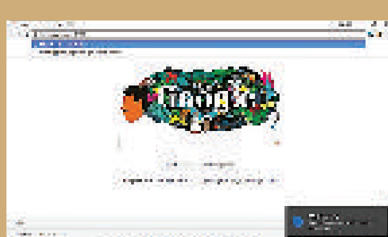
ICT CORNER

CHECK THE LOGOS OF GIVEN ORGANISATIONS

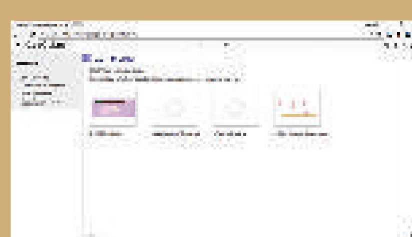
Identify the logos of organizations

STEPS:

- Open the Browser and type the URL given (or) Scan the QR Code.
- GeoGebra Work book called "COMMERCE" will appear. In this several work sheets for Commerce are given, Open the worksheet named "check the logos of given organisations"
- Click on the boxes before the organisation names.
- Logos of respective organisations will appear as above.



Step1



Step2

Step3

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*Images are indicative only

UNIT II FORMS OF BUSINESS ORGANISATION

CHAPTER 9 GOVERNMENT ORGANISATION

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Learning Objectives

To enable the students to understand

i. the meaning of Departmental undertaking, features, advantages and disadvantages

ii. the meaning of Public Corporation, features, advantages and disadvantages

iii. the meaning of Government Company, features, advantages and disadvantages

Introduction

Public enterprise, as a form of business organization gained economic importance in most of the countries of the world in recent years. During the twentieth century, various Governments started participating in industrial and commercial activities. Previously, the role of Government was limited only to the maintenance of law and order. Industrial revolution helped all-round growth of industries. Private entrepreneurs worked, only for the profit motive. The exploitation of consumers and workers by private entrepreneurs was very common. The development of industries was left to the judgement of private enterprises. Therefore, Government intervention became necessary to safeguard the interests of the public, even in developed countries like USA and UK.

The Government thus, can own and control industry and business in two ways:

i. By starting a new unit

ii. By taking over an existing industrial or commercial unit owned by private persons.

9.01 Meaning and Features of Departmental Undertaking

Department form of organisation of managing state enterprises is the oldest form of organisation. In those days, no distinction was made between the routine functions of the Government and that of the public enterprises. Therefore, most of the early state owned enterprises were the best examples of the departmental form of organisation.Under departmental form of organisation, a public enterprise is run as a separate full-fledged ministry or as a major sub-division of a department of the Government.

For example, the Indian Railways are managed by the Ministry of Railways. Post and Telegraph services are run as a department, under the Ministry of Communication. The Delhi Milk Scheme, All India Radio, Doordarshan are other examples of departmental undertakings.

Features of Departmental Undertaking

The salient features of a departmental undertaking are as follows:

i. Ultimate Responsibility

The ultimate responsibility for the management of a departmental undertaking lies with the minister concerned; who is responsible to the Parliament or State Legislature for the affairs of the departmental undertaking. The minister, in turn, delegates his authority downwards to various other management levels, in the departmental undertaking.

ii. Governmental Financing

The departmental undertaking is financed through annual budget appropriations by the Parliament or the State Legislature. The revenues of the undertaking are paid into the government treasury.

iii. Accounting and Audit

The departmental undertaking is subject to the normal budgeting, accounting and audit procedures, which are applicable to all Government departments.

iv. Managed by Civil Servants

The departmental undertaking is managed by civil servants, who are subject to same service conditions as applicable to civil servants of the Government.

v. Sovereign Immunity

A departmental undertaking cannot be sued anybody, without the consent of the Government.

9.02 Advantages and Disadvantages

Advantages

Following are the advantages of the departmental undertaking.

i. Easy Formation

It is easy to set up a departmental undertaking. The departmental undertaking is created by an administrative decision of the Government, involving no legal formalities for its formation.

ii. Direct and Control of Parliament or State Legislature

The departmental undertaking is directly responsible to the Parliament or the State legislature through its overall head i.e. the minister concerned.

iii. Secrecy Maintained

Strategic industries like defence and atomic power cannot be better managed other than government departments. Department undertakings can maintain secrecy in their working.

iv. Lesser Burden of Tax on Public

Earnings of departmental undertaking are entirely paid into Government treasury, resulting in lesser tax burden on the public.

v. Instrument of Social Change

Government can promote economic and social justice through departmental undertakings. Hence, a departmental undertaking can be used by the Government, as an instrument of social change.

vi. Lesser Risk of Misuse of Public Money

As the departmental undertaking is subject to budgeting, accounting and audit procedures of the government; the risk of misuse of public money is relatively less.

vii. Guided by Rules and Regulations of the Ministry

The officers of the departmental undertaking are under the supervision of the direct administrative control of the ministry. They are guided by the rules and regulations of the ministry, framed with a focus on public welfare.

Disadvantages

Following are the major limitations of the departmental undertaking.

i. Red-tapism

There is too much of procedures which results in delay. Commercial organisation cannot afford delay in taking decisions.

ii. Incidence of Additional Taxation

Losses incurred by a departmental enterprise are met out of the treasury. This very often necessitates additional taxation the burden of which falls on the common man.

iii. Lack of Competition

Civil Servants are given control of these undertakings who may not have business outlook or commercial experience. So, they run the undertaking in their own fashion without considering the sovereignty of the consumers.

iv. Casual Approach to Work

As officers of a departmental undertaking are subject to frequent transfers; they develop a sense of casual approach to work. As a result, the operational efficiency of the undertaking suffers a lot.

v. Government Interference

There is an excessive government interference and control in department organisation. These undertakings are not given freedom to decide their own policies. Centralised control leads to delay in action. Red-tapism and bureaucracy have become the limiting features of these organisations

vi. Lack of Professional Management and Fear of Criticism

A departmental undertaking is managed by civil servants, who do not possess professional management skills. Moreover, these managers could not afford to be innovative, because of a fear of criticism by the minister or the Parliament.

vii. Financial Dependence

A departmental undertaking is economically and financially dependent on the Government's budgetary allocations. As such, it cannot have its own independent long range investment decisions, which may bring enormous prosperity to the undertaking.

9.03 Meaning and Features of Public Corporation

A public corporation is that form of public enterprise which is created as an autonomous unit, by a special Act of the Parliament or the State Legislature.

Since a public corporation is created by a Statute; it is also known as a statutory corporation.

The Statute defines the objectives, powers and functions of the public corporation. Life Insurance Corporation of India, the Indian

Airlines, the Air India International, Oil and Natural Gas Commission etc. are some examples of public corporations in India.

List of Indian Departmental Undertaking and their Logo

Company	Headquarter	Company Logo
Indian Railway	New Delhi	
Department of Food and Public Distribution	New Delhi	
Tamilnadu Police Department	Chennai	

Features of Public Corporation

i. Special Statute

A public corporation is created by a special Act of the Parliament or the State Legislature. The Act defines its powers, objectives, functions and relations with the ministry and the Parliament (or State Legislature).

ii. Separate Legal Entity

A public corporation is a separate legal entity with perpetual succession and common seal. It has an existence, independent of the Government. It can own properly; can make contracts and file suits, in its own name.

iii. Capital Provided by the Government

The capital of a public corporation is provided by the Government or by agencies controlled by the government. However, many public corporations have also begun to raise money from the capital market.

iv. Financial Autonomy

A public corporation enjoys financial autonomy. It prepares its own budget; and has authority to retain and utilize its earnings for its business.

v. Management by Board of Directors

Its management is vested in a Board of Directors, appointed or nominated by the Government. But there is no Governmental interference in the day-to-day working of the corporation.

vi. Own Staff

A publication corporation has its own staff; whose appointment, remuneration and service conditions are decided by the corporation itself.

vii. Service Motive

The main objective of a public corporation is service-motive; though it is expected to the self-supporting and earn reasonable profits.

viii. Public Accountability

A public corporation has to submit its annual report on its working. Its accounts are audited by the Comptroller and Auditor General of India. Annual report and audited accounts of a public corporation are presented to the Parliament or State Legislatures, which is entitled to discuss these.

9.04 Advantages and Disadvantages

Advantages

i. Bold Management due to Operational Autonomy

A public corporation enjoys internal operational autonomy; as it is free from Governmental control. It can, therefore, run in a businesslike manner. Management can take bold decisions involving experimentation in its lines of activities, taking advantage of business situations.

ii. Legislative Control

Affairs of a public corporation are subject to scrutiny by Committees of Parliament or State Legislature. The Press also keeps a watchful eye on the working of a public corporation. This keeps a check on the unhealthy practices on the part of the management of the public corporation.

iii. Qualified and Contented Staff

Public corporation offers attractive service conditions to its staff. As such it is able to attract qualified staff. Because of qualified and contented staff, industrial relations problems are not much severe. Staff has a motivation to work hard for the corporation.

iv. Tailor-Made Statute

The special Act, by which a public corporation is created, can be tailor-made to meet the specific needs of the public corporation; so that the corporation can function in the best manner to achieve its objectives.

v. Not Affected by Political Changes

Being a distinct legal entity, a public corporation is not much affected by political changes. It can maintain continuity of policy and operations.

vi. Lesser Likelihood of Exploitation

The Board of Directors of a public corporation consists of representatives of various interest groups like labour, consumers etc. nominated by the Government. As such, there is lesser likelihood of exploitation of any class of society, by the public corporation.

vii. Reasonable Pricing Policy

A public corporation follows a reasonable pricing policy, based on cost-benefit analysis. Hence, public are generally satisfied with the provision of goods and services, by the public corporation.

Disadvantages

i. Autonomy and Flexibility, Only in Theory

Autonomy and flexibility advantages of a public corporation exist only in theory. In practice, there is a lot of interference in the working of a public corporation by ministers, government officers and other politicians.

ii. Misuse of Monopolistic Power

Public corporations often enjoy monopoly in their field of operation. As such, on the one hand they are indifferent to consumer needs and problems; and on the other hand, often do not hesitate to exploit consumers.

iii. Rigid Constitution

The constitution of a public corporation is very rigid. It cannot be changed, without amending the Statute of its formation. Hence, a public corporation could not be flexible in its operations.

iv. Low Managerial Efficiency

Quite often civil servants, who do not possess management knowledge and skills, are appointed by the government on the

Board of Directors, of a public corporation. As such, managerial efficiency of public corporation is not as much as found in private business enterprises.

v. Problem of Passing a Special Act

A public corporation cannot be formed without passing a special Act; which is a time consuming and difficult process. Hence, the scope for setting up public corporations is very restricted.

vi. Clash of Divergent Interests

In the Board of Directors of public corporation, conflicts may arise among representatives of different groups. Such clashes tell upon the efficient functioning of the corporation and may hamper its growth.

9.05 Meaning and Features of Government Company

A "Government company" is defined under Section 2(45) of the Companies Act, 2013 as "any company in which not less than 51% 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 and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company".

Features of Government Company

i. Registration Under the Companies Act

A Government company is formed through registration under the Companies Act, 1956; and is subject to the provisions of this Act, like any other company. However, the Central Government may direct that any of the provisions of the Companies Act shall not apply to a Government company or shall apply with certain modifications.

List of Public Corporations and their Logo

Company	Headquarter	Company Logo
Food Corporation of India (FCI)	New Delhi	
ONGC	New Delhi	
Tourism Corporation of India	New Delhi	

ii. Executive Decision of Government

A Government company is created by an executive decision of the Government, without seeking the approval of the Parliament or the State Legislature.

iii. Separate Legal Entity

A Government company is a legal entity separate from the Government. It can acquire property; can make contracts and can file suits, in its own name.

iv. Whole or Majority Capital Provided by Government

The whole or majority (at least 51%) of the capital of a Government company is provided by the Government; but the revenues of the company are not deposited into the treasury.

v. Majority of Government Directors

Being in possession of a majority of share capital, the Government has authority to appoint majority of directors, on the Board of Directors of a government company.

vi. Own Staff

A Government company has its own staff; except Government officials who are sent to it on deputation. Its employees are not governed by civil service rules.

vii. Free from Procedural Controls

A Government company is free from budgetary, accounting and audit controls, applicable to Government undertakings.

viii. Accountability to the Parliament / State Legislature

The Annual Report of a Government company is placed before the Parliament or the State Legislature.

9.06 Advantages and Disadvantages

Advantages

i. Easy Formation

A Government company can be easily formed under the Companies, Act, just by an executive decision of the government.

ii. Internal Autonomy

A government company can manage its affairs independently. It is relatively free from ministerial control and political interference, in its day-to-day functioning.

iii. Private Participation

Through Government company device, the government can avail of the management skills, technical know-how and expertise of the private sector and foreign countries. For example, the Hindustan Steel Limited has obtained technical and financial assistance from the U.S.S.R., West Germany and the U.K. for its steel plants at Bhilai, Rourkela and Durgapur.

iv. Easy to Alter

Objectives and powers of the Government Company can be changed by simply altering the Memorandum of Association of the company, without seeking the approval of the Parliament.

v. Discipline

The Government Company is subject to provisions of the Companies Act; which keeps the management of the company active, alert and disciplined.

vi. Professional Management

A Government company can employ professionally qualified managers; because it has its own personnel policies.

vii. Public Accountability

The Annual Report of a Government company is presented to the Parliament/ State Legislature. These reports can be discussed and debated there.

Disadvantages

i. Board of Directors Packed with 'Yes-Men'

On the Board of Directors of a government company, there are Government appointed directors (Government being the major shareholder); who are 'yes-men' of the Government. They are unable to run the company, in a businesslike manner.

ii. Autonomy Only in Name

Independent character of a Government company exists only in name. In reality, politicians, ministers, Government officials, interfere excessively in the day-to-day working of the government company.

iii. A Fraud on Companies Act and Constitutions

A Government company is criticized as being a 'fraud on the Companies Act and on the Constitution. This criticism is valid on the ground that the Government can exempt a Government company from application of several provisions of the Companies Act. Again, the Parliament is not taken into confidence, while creating a Government company.

iv. Fear of Exposure

The annual report of the government company is placed before the Parliament/ State Legislature. The working of the company is exposed to Press criticism: Therefore, management of the Government Company often gets demoralized and may not take initiative to come out with and implement something innovative.

list of Government Company and their Logo

Company	Headquarter	Company Logo
Coal India Ltd	Kolkata	
Steel Authority of India Ltd	New Delhi	
Tamil Nadu State Transport Corporation Ltd.	Chennai	
Gas Authority of India Limited	New Delhi	GAIL (India) Limited

v. Lack of Expertise in Deputationists

The key personnel of a Government company are often deputed from Government departments. These deputationists generally lack expertise and commitment; leading to lower operational efficiency of the government company.

vi. Selfish Functioning

The Government Company works neither for the government nor for the public at large. It serves the personal interests of people who work in the company and who dictate policies of the company.

Key Terms

Departmental Undertaking

Public Corporation

Government Company

Nationalisation

For Own Thinking

1. Name any two examples of Departmental undertaking business.
2. Name any two examples of Public corporation.
3. Name any two examples of Government Company.

For Future Learning

(a) Organise a debate in your class on the motion "Public Enterprises in India have failed to achieve their objectives". Select a few good speakers for the purpose. State the points for and against the motion.

(b) Recently a discussion on "The objectives of Public sector undertakings was organised by the Friends Circle, a private cultural organization of the city of Chennai. One of the participants, Mr.Ramesh happened to be a social worker. He observed, "the objective of Public Enterprises is to serve the Society and not to earn profits". Mr.Deepesh, an advocate, objected to Mr.Ramesh's statement and gave his own view point. Thus continued the discussion.If you have participated in that discussion, what should have been your stand and why?

Case Study

Case 1: You are a newly appointed MD of a foreign sector tourist Bus transport company. The management of the bus Transport undertaking of your city finds that its buses are not able to attract very many tourists. Private Mini-Buses are seen to be preferred by people on certain routes. As a result, the undertaking is incurring losses. Therefore, management wants to reformulate its price policy. As a CEO or MD what advice can you give to it? Explain.

Case 2: Mr.Sudhan is studying in B.Com, 1st year. His father, Mr.Somu is a leading businessman in Chennai. Somehow, Mr.Sudhan does not know anything about utilities. But he is to prepare a lesson for his class in this topic. He request his father for help. His father tells Mr.Sudhan that Public utilities are no different from his own business except that these are controlled by Government instead of private people. Meanwhile, Mr.Chandrasekaran a friend of Mr.Somu comes there. Mr.Chandrasekaran is an employee of Chennai Electricity Supply Undertaking. Mr.Chandrasekaran intervenes in the conversation going on between Mr.Somu and his son and hold that Mr.Sudhan is not correct; there are other special features of public uutilities, too. Perform the characters of Mr.Sudhan, Mr.Somu and Mr.Chandrasekaran and state your positions.

Exercise

I. Choose the Correct Answer

1. **The share capital of the government company must not be less than**

   a) 75 %   b) 60 %

   c) 95 %   d) 51 %

2. **The oldest form of organisation in public sector**

   a) Public Sector Undertakings

   b) Departmental Undertakings

c) Multi National Corportions

d) Statutory Corportion

4. A Government company purchases shares in the name of

a) Prime Minister

b) President

c) Chief Justice of India

d) State Chief Minister

5. The primary objective of the state enterprises is to ______

a) Earn profit

b) Provide Employment

c) Serve the People

d) All the Above

Answers

1. d 2. b 3. b 4. c

II. Very Short Answer Questions

1. Give two examples of Public Corporation.
2. Give two examples of Departmental Undertaking.
3. What is meant by Red-Tapism?

III. Short Answer Questions

1. What is meant by Departmental undertakings.
2. What is meant by Government Company?
3. What is meant by Public Corporations?

IV. Long Answer Questions

1. What are the advantages of Departmental undertaking? (any 5)
2. What are the features of Public Corporations? (any 5)
3. What are the features of Government Company? (any 5)

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UNIT III SERVICE BUSINESS - I

CHAPTER 10 RESERVE BANK OF INDIA

Learning Objectives

To enable the students to

i. understand the meaning of central bank

ii. gain knowledge about the origin of the Reserve Bank of India

iii. describe the functions of the RBI

10.01 Need for the Study on Service Business

Educational, medical, hospitality and the like service business existed for centuries. Its prominence in the global trade is of recent origin i.e., after 1970. "The services sector has emerged as the most dynamic sector of the world economy, contributing almost one-third of world gross value added, half of world employment, one-fifth of global trade and more than half of the world foreign direct investment flows. It remains the key driver of India's economic growth, contributing almost 66.1 per cent of its gross value added growth in 2015-16" - quotes the Indian Budget Estimate for 2015-16.

10.02 Banking Service

Banking service is the nerve center of industry and commerce in a country. It plays a vital role by providing the money required for their regular functioning and development. The word Bank, normally refers to commercial bank. There are many types of banks rendering different types of services. Central Bank is the most important one among them.

Every nation has one central bank. It is owned by the Government of the country. The control over the entire banking system of a country is vested with this apex bank. Central banks are known by different names in different countries. Their functions also vary from country to country. A Central bank is set up as an autonomous or quasi-autonomous body. Stability and growth of the country's economy are the main goals of a Central bank. In India the Reserve Bank of India (RBI) is the central bank.

10.03 The Historical Development of Banks in India

i. Bank of Hindustan was the first bank in India established in 1770 and was closed in 1932.

commerce 1-15.indd 86 17-12-2021 8.26.36 PM

Banking in ancient India

Rudimentary banking activities were carried out in India 3500 years ago (1500 CE). Interest earning and usury (unreasonable interest) were prevalent during the Vedic period. 1200 years before (8th century CE) the following concepts were in practice in Tamil Nadu: Patru-debit, Varavu-credit, Selavu-expenditure, Laabam-profit, Nashtam-loss, which all collectively known as 'Iynthogai'-trial balance-. 'Peredu' referred to Ledger

Bronze coins used during Raja Raja Chola Period 985-1014 CE

ii. The General Bank of India was established in 1786 and was also liquidated in 1791.

iii. Bank of Calcutta was the first joint stock bank established in 1806. It was renamed as the Bank of Bengal in 1809.

iv. Bank of Bombay in 1840 and Bank of Madras in 1843 were established."These banks are called Presidential Banks"(Bengal, Bombay and Madras only)

1881witnessed the birth of 'Audh Bank' , which was later renamed into Punjab National Bank in 1894 (19-05-1894).

These Presidential Banks were amalgamated into the Imperial Bank of India on 27 January 1921. It confined its operations to the urban sector and rural sector was completely neglected in those days. Therefore, after Independence, an Act was passed in Parliament to take over the Imperial Bank of India by the Government and State Bank of India came into being on July 1, 1955.

Stamp of Imperial Bank of India

10.4 Bank Definition

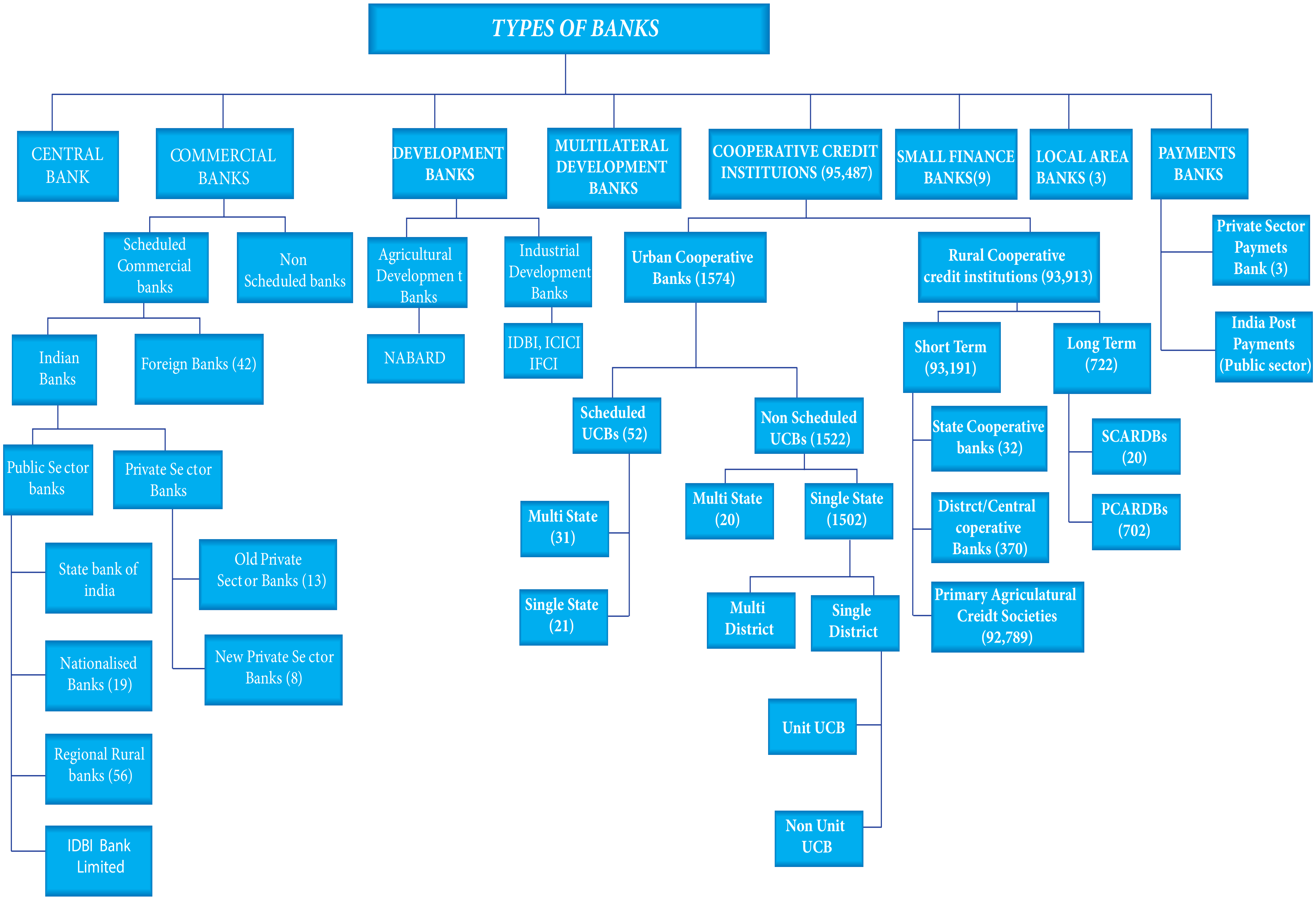
According to Banking Regulation Act 1949, "Banking means the accepting for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, pay order or otherwise".

DO YOU KNOW?

14 Banks were nationalised in India in the year 1969

6 Banks were subsequently nationalised in India in the year 1980

NABARD stands for ....

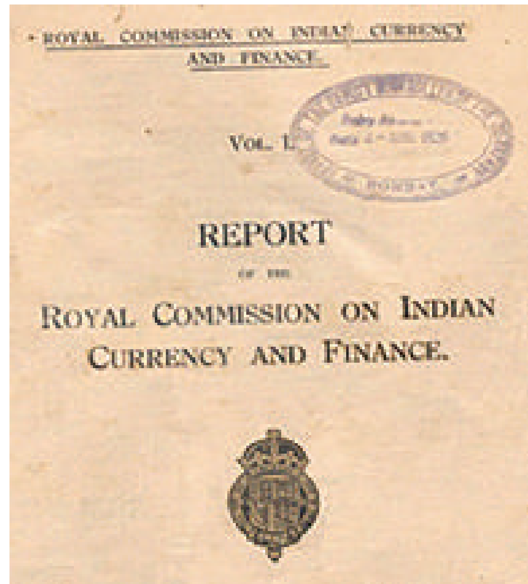

TYPES OF BANKS
CENTRAL BANK
COMMERCIAL BANKS
DEVELOPMENT BANKS
MULTILATERAL DEVELOPMENT BANKS
COOPERATIVE CREDIT INSTITUIONS (95,487)
SMALL FINANCE BANKS(9)
LOCAL AREA BANKS (3)
PAYMENTS BANKS
Scheduled Commercial banks
Non Scheduled banks
Agricultural Developmen t Banks
Industrial Development Banks
Urban Cooperative Banks (1574)
Rural Cooperative credit institutions (93,913)
Private Sector Paymets Bank (3)
India Post Payments (Public sector)
Indian Banks
Foreign Banks (42)
NABARD
IDBI, ICICI IFCI
Short Term (93,191)
Long Term (722)
Scheduled UCBs (52)
Non Scheduled UCBs (1522)
State Cooperative banks (32)
SCARDBs (20)
Public Se ctor banks
Private Se ctor Banks
Multi State (20)
Single State (1502)
Multi State (31)
Distrct/Central coperative Banks (370)
PCARDBs (702)
State bank of india
Old Private Sect or Banks (13)
Single State (21)
Multi District
Single District
Primary Agriculatural Creidt Societies (92,789)
Nationalised Banks (19)
New Private Se ctor Banks (8)
Unit UCB
Regional Rural banks (56)
Non Unit UCB
IDBI Bank Limited

10.05 Definition of Central Bank

1. "A central bank being generally recognized as a bank which constitutes the apex of the monetary and banking structure of its country and which performs as best as it can, in the national economic interest." - De Kock. He gave a list of seven functions of central bank which are accepted by majority of economists.
2. "It may be defined as an institution charged with the responsibility of managing the expansion and contraction of the volume of money in the interest of the general public welfare." - Kent.
3. "A Central Bank is the bank in any country to which has been entrusted the duty of regulating the volume of currency and credit in that country." - Bank of International Settlement (BIS).

10.06 Origin of RBI

The Imperial Bank of India carried out the note issue and other functions of the central bank. In 1926 the Hilton-Young Commission or the Royal Commission on Indian Currency and Finance (J. M. Keynes and Sir Ernest Cable were its members) made recommendation to create a central bank. As a result, the RBI Act 1934 was passed and RBI launched in operations from April 1, 1935. RBI was established with a share capital of ₹5 crores divided into shares of ₹100 each fully paid up. The entire share capital was owned by private shareholders. Its head office was in Calcutta and moved to Mumbai in 1937.



After independence, the Government of India passed Reserve Bank (Transfer to Public Ownership) Act, 1948 and took over RBI after paying appropriate compensation to the private shareholders. From January 1, 1949, RBI started functioning as a government owned central bank of India. It had three departments. The RBI was the central bank of Burma until 1947, and the central bank of Pakistan until June 1948.

Emblem of RBI

10.07 Organisational Structure of RBI

The head office of the RBI is situated in Mumbai. This central office has 33 departments in 2017. It has four zonal offices in Mumbai, Delhi, Calcutta and Chennai functioning under local boards with deputy governors as their heads. It also has 19 regional offices and 11 sub-offices (2017). The RBI is governed by a Central Board of Directors. The 21 member board is appointed by the Government of India. It consists of;

a. one governor and four deputy governors appointed for a period of four years,

b. ten directors from various fields

c. two Government officials

d. four directors - one each from local boards.

10.08 Functions of RBI

The functions of the RBI can be grouped under three heads.

A. Leadership and Supervisory Functions
B. Traditional Functions and
C. Promotional Functions.

A. Leadership and Supervisory Functions

India being the fastest growing economy in the world, India is expected to play a major role in the world affairs by many countries. RBI being the banking institutional head of India has to be a part of global institutions. It has to transform the quality and size of banks in India to the level of banks in developed countries. Such functions get prominence in current scenario.

1. India's Representative in World Financial Institutions

In order to maintain consistency and harmony with international banking standards the RBI is associated with Basel Committee on Banking Supervision (BCBS, Switzerland) since 1997. RBI represents Government of India in International Bank for Reconstruction and Development (IBRD i.e. World Bank) and International Monetary Fund (IMF) in which India is a member since December 27, 1945.

2. Regulator and Supervisor of Indian Banking System

The broad guidelines for all banking operations in the country are formulated by the RBI. The RBI has power to issue licenses, control and supervise commercial banks under the RBI Act, 1934 and the Banking Regulation Act, 1949. It conducts inspection of the commercial banks and calls for returns and other necessary information from them.

3. Monetary Authority

The RBI formulates, implements and monitors the monetary policy of the country in order to maintain price stability, controlling inflationary trends and economic growth. It provides advices to the Government concerning agricultural finance, resource mobilization for implementing plans and legislation affecting banking and credit and international finance.

4. Closely Monitoring Economic Parameters

Broad economic parameters such as employment level, price levels and production levels, trade cycles, foreign investment flows, balance of payments, financial markets, etc., are closely monitored by the RBI in order to achieve economic stability and growth. The Board of Financial Supervision (a committee of the Central Board of Directors) of the RBI meets at least once in a month (at times every day) to closely monitor all these current developments in the country.

5. Promptly Responding to New Challenges

Whenever challenges arose before Indian Banking System, RBI promptly attend them by issuing Master Circulars and by organising committees to analyse, review and strengthen Indian Banking. A wealth of information can be found in every Master Circular or committee report. Example: Gopalakrishnan Committee on "Information security, Electronic Banking", April, 2010

B. Traditional Functions

1. Banker and Financial Advisor to the Government

The RBI accepts money into the Central and State Governments' accounts and make payments on their behalf. It manages Government debt and is responsible for issue of new loans. It advises the government on the quantum, timing and terms of new loans. It provides 'ways and means advances' to the Governments to tide over temporary financial needs. It takes up the responsibility of investment of the surplus Government funds. Inter Government and inter departmental account adjustments are carried out by the RBI.

2. Monopoly of Note Issue

The RBI is the sole authority for the printing and issue of all currency notes in India except one rupee note. It is the duty of the RBI to ensure that sufficient number of good quality currency notes is available to the public. It exchanges currency and coins not fit for circulation. One rupee note and all coins are issued by the Ministry of Finance. Currency notes are printed at Nasik, Dewas, Salboni, Mysore and Hoshangabad. (Currency notes are never printed outside India).

3. Banker's Bank

The relationship between RBI and other banks in the country is just like the relationship of a commercial bank with its customers. The RBI maintains the current accounts of all commercial banks in the country. All scheduled banks should deposit a percentage of cash reserve with RBI. All banks can receive loans from RBI by rediscounting of bills and against approved securities.

4. Controller of Credit and Liquidity

Controlling the credit money in circulation and the interest rate in the country is a major function of RBI. For this purpose, the RBI uses quantitative and qualitative methods of credit control. Ensuring the availability of sufficient cash and credit (liquidity) for business transactions and investment purposes in the economy is the responsibility of RBI.

(a) Quantitative Methods of Credit Control

The methods which influence the total volume of credit in Indian economy are called quantitative or general methods. An increase in the first three measures will reduce the volume of money in circulation in India and vice versa.

i. ***Bank Rate Policy:*** Bank rate refers to the rate at which the RBI rediscounts the bills given by the Scheduled banks.

> Repo rate is the repurchase rate at which the RBI repurchases the Government securities (other securities also) from the Scheduled banks and gives loans. Reverse repo rate is the rate at which the RBI borrows money from Commercial banks by giving back those Government securities.

ii. ***Cash Reserve Ratio (CRR):*** It is the ratio of Cash reserves with the RBI kept by Scheduled banks in proportion to the total Time and Demand Liabilities with them.

iii. ***Statutory Liquidity Ratio (SLR):*** It is the ratio of money and money equivalents kept within the bank in proportion to the total Time and Demand Liabilities with them.

iv. ***Open Market Operations:*** The RBI directly buys or sells the securities and bills in the money market either to decrease or to increase the total volume of money.

(b) Qualitative Credit Control Measures:

These methods influence the volume of money in selected or particular sectors of the economy.

i. ***Rationing of credit:*** Maximum limit is fixed for lending to certain sectors or specific purposes.

ii. ***Marginal Requirement:*** It refers to the percentage of the value of securities submitted before issue of loans.

iii. ***Direct Action:*** The RBI takes corrective actions on any bank or banks that does not follow its guidelines. It is called direct action.

iv. ***Moral Suasion:*** The RBI puts pressure on the banks towards liberal or restricted lending during certain periods.

5. Lender of the Last Resort

In times of emergency any bank in India can approach RBI for financial assistance. RBI provides them credit. When other sources of getting credit are exhausted, all banks can obtain loan from RBI and hence it is called lender of last resort.

6. Clearing House Services

RBI acts as clearing house and maintains a clearing system for all commercial banks in India. The aggregate amount of cheques presented by a bank on other banks represents the claim by that bank on other banks. Similar claims are made by all the banks on every other bank in the clearing. A net settlement is arrived at the clearing house and accordingly the debit or credit entry is made in their current accounts. The cash reserves kept by the banks with RBI is utilised for this purpose. Clearing system saves time and eliminates paperwork and other difficult (otherwise tasks) tasks involved in inter-bank settlement. Though the RBI maintains the clearing house system only 14 clearing houses are owned by the RBI, 840 are managed by SBI and 6 by nationalised banks (total 860).

7. Custodian of Foreign Exchange Reserves

The RBI maintains a reserve of gold and foreign currencies. When foreign exchange reserves are inadequate for meeting balance of payments problem, it borrows from the International Monetary Fund (IMF). It also administers exchange control of the country and enforces the provisions of Foreign Exchange Management Act, 1999. Development and maintenance of foreign exchange market in India is also the function of RBI.

8. Maintenance of Foreign Exchange Rate

The RBI manages the exchange value of the rupee in order to facilitate India's foreign trade and payments. It ensures that normal short-term fluctuations in trade do not affect the exchange rate.

9. Collection and Publication of Authentic Data

It has also been entrusted with the task of collection and compilation of statistical information relating to banking and other financial sectors of the economy. RBI monthly bulletin, annual report and various committee reports contain treasures of authentic data.

(C) Promotional Functions

The RBI performs a wide range of promotional functions to support national objectives.

1. Nurturing Banking Habits among the Public

It is the responsibility of RBI to maintain the public confidence in the banking system. It protects the depositors' interest and aim at providing cost-effective banking services in order to include more people to avail banking services. It has also taken up the task of extending the banking system territorially and functionally to the unbanked areas.

2. Grievance Settlement Measures

RBI has appointed 20 (up to 2017) Banking Ombudsman in 20 state capitals. Banking Ombudsman Scheme is a speedy and inexpensive forum for resolution of customer complaints relating to certain services rendered by banks in India.

3. Agricultural Development

Agriculture industry is specified as priority sector by the RBI. The loans of all scheduled banks should consist of a percentage of loans to priority sector. It works in close association with NABARD to develop agriculture in India.

4. Promotion of Small Scale Industries

Micro Small and Medium Enterprises are included in the priority sector. All scheduled banks are required to open separate branches to specialise the financing of these industries.

5. Facilitates Foreign Trade

The RBI has simplified the rules for credit to exporters, through which they can now get long term advance from banks.

6. Supports Cooperative Sector

It helps cooperative banks by relaxing rules and providing indirect financing.

The rupee symbol was changed from Rs. to " ₹ " by the Government of India on July 15, 2010. This became necessary since other countries Indonesia, Mauritius, Nepal,

Achievements of the RBI

1. RBI is one of the best central banks in the world. RBI took proactive measures during global economic slowdown in 2008-09 to save Indian economy.
2. National Bank for Agriculture and Rural Development (NABARD) was once a subsidiary of RBI. It is the first of its kind in the entire world.
3. The demonetisation in 2016-17 was a grand success because of the leadership role of the RBI.

Pakistan and the Seychelles also called their currencies rupee. Among global currencies Indian rupee is given the code INR (Indian Rupee) by the International Organisation for Standardisation.

DO YOU KNOW?

Demonetisation and Remonetisation

Government of India on the recommendation of the RBI carried out demonetization on November 8, 2016 in order to; a) to crack a whip against black money, b) drive out counterfeit currency in circulation, c) formalization of cash dependent business, and d) dismantling the financial strength of terrorism and naxalism. There were ₹ 17,118 billion value of ₹ 500 and ₹1000 currency notes in circulation before demonetisation. They consisted of around 2,203 crore pieces of notes. Of these 98.96% notes were returned to the banks. Subsequently remonetisation was carried out by issuing new ₹ 2000 and ₹ 500 currency notes.

Key Terms

Amalgamation
Lender of last resort
Clearing house
Banking ombudsman.

For Own Thinking

A Debate on demonetisation and remonetisation

For Future Learning

1. Know the Central Banks of Some other Countries
   The Central Bank of Russia is the Bank of Russia
   The Central Bank of Sri Lanka is the Central Bank of Sri Lanka
   - The Central Bank of the USA is ______________________
   - The Central Bank of Pakistan is ______________________
2. Mention the names of Central Banks in three other countries
   i.....................
   ii.....................
   iii.....................
3. Understand the concepts monetary authority, banking system, financial system
4. Collection of names of RBI Governors
5. Collection of photo copy of currencies and coins in India.

Case Study

1. Take up a recent newspaper clipping about RBI such as the measures taken to reduce NPA. etc.
2. Arrange for a group discussion on customer grievances and the cases settled by Banking Ombudsman offices.
3. Visit the RBI website www.rbi.org.in to read and have a discussion on any annual report, etc.

Exercise

NK03D

I. Choose the Correct Answer

1. Which bank has the power to issue bank notes?

(a) Central bank

(b) Commercial bank

(c) Co-operative banks

(d) Foreign banks

2. The Central bank of India is

(a) PNB

(b) SBI

(c) ICICI

(d) RBI

3. The Reserve Bank of India commenced its operations from April 1,

(a) 1936

(b) 1935

(c)1934

(d) 1933

4. Bankers are not only dealers of money but also leaders in

(a) Economic development

(b) Trade development

(c) Industry development

(d) Service development

5. Which of the following is not a function of a central bank?

(a) Guiding and regulating the banking system of a country

(b) Deal with the general public

(c) Acts essentially as Government banker

(d) Maintains deposit accounts of all other banks

Answers

1. (a) 2. (d) 3.(b) 4.(a) 5. (b)

II. Very Short Answer Questions

1. What are the services included in Service businesses?
2. Write the meaning of 'Bank'.
3. Briefly explain about Central Bank.

III. Short Answer Questions

1. What are the functions of RBI? (any 3)
2. Explain the origin of RBI.
3. Who are the persons involved in RBI administration?

IV. Long Answer Questions

1. Classify the various functions of Reserve Bank of India. (any 5)

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UNIT III SERVICE BUSINESS - I

CHAPTER 11 TYPES OF BANKS

Learning Objectives

To enable the students to
i. understand the various types of banks
ii. describe the activities of various types of banks
iii. compare one type of bank with another one

11.01 Introduction

There are different types of banks performing different sets of functions. Though all types of banks deal in money, each type cater to the needs of different sectors. Therefore a study of all these types of banks is essential. Different types of banks can be understood by a glance at the chart given in the chapter 10.

11.02 Types of banks

Banks can be classified as follows.

A. Based on the functions of banks

B. Based on the status given by the RBI - Reserve Bank of India

C. Based on the ownership pattern

A. Based on the functions of banks

1. Central Bank – Refer to Chapter 10

2. Commercial Banks

Banks which accept deposits from the public and grant loans to traders, individuals, agriculture, industries, transport, etc. in order to earn profit. Their lending is in comparatively small amounts and mostly for short and medium period. They also provide other services like remittance of funds, safe keeping of valuables, collection of cheques, s, issue of letters of credit, etc. They operate with a head office and a network of branch offices spread throughout the country. They also issue guarantees to businessmen. When a businessman or industrialist buy machinery on credit or apply for a big contract bank guarantees that in case the customer fails the bank will make the payment.

Examples:

i. State Bank of India
ii. Karur Vysa Bank
iii. Standard Chartered Bank

3. Development Banks

Huge finance required for investment, expansion and modernisation of big industries and others are granted by a separate type of banks called development Banks. They are also called industrial banks. The objective of development banks is not profit. Their aim is to develop the country and create employment opportunities. Finance is provided by them for medium and long terms ranging from five to twenty years. Development banks do not accept deposits from the public. They subscribe the shares and debentures of the industries. They provide technical and managerial consultancy services to industrialists. IDBI Bank established as the apex development bank in I964 and was transformed into public sector commercial bank in 2004. Currently it performs both development bank and commercial bank functions. Its name changed into IDBI Bank Limited in 2008. When a development bank is established for the development of agriculture industry it is called agricultural development bank. National Bank for Agriculture and Rural Development is such a bank

Examples:

i. Industrial Finance Corporation of India - IFCI
ii. Small Industries Development Bank of India -SIDBI
iii. MUDRA bank (for the development of micro industries)

4. Cooperative Banks

All cooperative banks in India are owned by its customers or members who are farmers, small traders and others. Cooperative banks in India are either urban based or rural based. Rural cooperative banking structure in India has three tier structure for short term loans and two tier structure for long term loans (refer chart). For both these structures the apex body is National Bank for Agricultural and Rural Development - NABARD. All cooperative banks in Tamil Nadu are registered under Tamil Nadu Cooperative Societies Act 1983. They are controlled by both RBI and the State Government. Their foremost objective is providing service to its members for rural and agricultural development and not profit earning. They are set up in towns and villages rather than cities. Compared to the commercial banks they offer less variety of services as the bye laws do not permit all commercial bank activities. National Cooperative Development Corporation (NCDC) established in 1963 is providing loans and grants to State Governments for financing cooperative societies. NCDC concentrates on projects like water conservation, irrigation, agri-insurance, rural sanitation, etc.

Examples:

i. National Agricultural Cooperative Marketing Federation of India Ltd. (NAFED) was set up in 1958 and registered under the Multi State Co-operative Societies Act.

ii. Tamil Nadu State Apex Cooperative Bank - Head Office, Chennai

iii. Madurai District Central Cooperative Bank Ltd.

v. Batlagundu Cooperative Urban Bank Ltd. Dindigul District

5. Foreign Banks

Banks which have registered office in a foreign country and branches in India are called foreign banks. These banks open their offices in big cities and port towns only. Mostly they serve the interests of the multinational companies, employees and other business institutions. Their profitability is higher than Indian banks. In 2017, there were 42 Foreign Banks in India and all of them were scheduled banks. They have to oblige both their home country banking regulations and the RBI regulations.

All about LDBs and Cooperative Credit Societies

1. In 1920, first Land Mortgage Bank (LMB) was established in India. Land Mortgage Act was passed in 1930. These banks provided long term loans to farmers mainly for redemption of debt. After 1960 LMBs started financing productive projects like digging of wells, installation of pump sets, etc. Thereafter they were called Land Development Banks. In view of the broader role of LDBs they are now known as SCARDBs. Under the RBI control there is no land development in India today.
2. First Cooperative Societies Act was passed in 1961 by Tamil Nadu Government. In 1983, it was repealed and a new Act was passed. All Cooperative banks in Tamil Nadu are controlled by this Act.
3. If the area of operation of the bank extends to two or more states, they are registered under Multi State Cooperative Societies Act, 2002.
4. Primary Agricultural Credit Societies (92,789 - refer chart) in India do not carry the name banks and they are not recognised by the RBI as banks. These societies should not receive deposits from the public. Insurance cover provided by the RBI to deposits are not available for them from the Deposit Insurance and Credit Guarantee Corporation.

Examples:

i. Bank of America - The USA

ii. Barclays Bank - The UK

iii. Deutsche Bank - Germany

6. Regional Rural Banks - RRBs

The RRBs were formed under the Regional Rural Bank Act 1976, jointly by the Central Government, State Government, and a sponsor bank. Their share capital is contributed by these sponsors in the ratio of 50:15:35. They are established as low cost institutions in rural areas. Their objective is to develop rural economy and play supplementary role to cooperative societies. They mobilise deposits from the rural public and provide finance to rural artisans, small entrepreneurs and farmers and try to avoid their dependency on money lenders. As on 31.3.2016, there were 56 RRBs in India with 14,494 branches. They are regulated and supervised by NABARD.

Examples:

i. Pallavan Grama Bank, Salem, Tamil Nadu

ii. Pandian Grama Bank,Thirumangalam, Madurai Dirstict, Tamil Nadu

iii. Vallalar Grama Bank, Chidambaram, Cuddalore District, Tamil Nadu

iv. Paduvai Bharathiyar Grama Bank, Villiyanur, Puducherry.

7. Specialised Banks

Some banks are created for special purposes by the Government. Export and Import Bank of India was set up through Export-Import Bank of India Act, 1981. Its main objective is to facilitate international trade of

Indian businessmen. EXIM Bank provides finance for import of technology, export product development, pre-shipment and post-shipment and overseas investment. National Housing Bank was established under the National Housing Bank Act, 1987. It is a wholly owned subsidiary of the RBI. The objective of NHB is to promote housing finance institutions at local and regional levels in India.

Example:

(i) Export - Import Bank of India (EXIM Bank)

(ii) National Housing Bank (NHB)

8. Local Area Banks

Local Area Bank (LAB) scheme was introduced by the RBI in August 1996. LABs are small private sector banks established in rural and semi-urban areas. Each bank serves two or three adjoining districts only. Their main objective is to mobilise rural savings (accept deposits) and invest them in the same areas. They have to follow the priority sector lending targets, including the targets on loans to weaker sections. RBI received 227 applications for setting up LABs. 10 were considered for approval and six were given license under Section 22 of the Banking Regulation Act, 1949. Only three LABs are functioning now.

Exmaples:

i. Coastal Local Area Bank, Vijayawada, Andhra Pradesh.

ii. Krishna Bhima Smruddhi Local Area Bank, Mahabubnagar, Telangana.

iii. Subhadra Local Area Bank Limited, Kolhapur, Maharashtra.

Deficiencies are found in the original model of LABs. There are practical difficulties in the operation of these banks. Even after 20 years (1996-2017) LABs could not make an impact in rural development. Therefore further licensing to LAB has been stopped.

9. Small Finance Banks

Small Finance Banks (SFBs) are private sector banks set up in unbanked and underbanked regions of the country to achieve financial inclusion. Their objectives are;

a. mobilising rural savings (accepting deposits) and

b. providing credit to

i. small and marginal farmers

ii. to micro and small industries and

iii other unorganised sector entities.

In September 2015, RBI granted provisional licenses to 8 Non-Banking Finance Companies (NBFCs) already engaged in microfinance to be converted into SFBs and 2 others. SFBs are low cost structure banks. They are formed under section 22 of the Banking Regulation Act 1949.

Examples:

i. ESAF SFB, Thiruvananthapuram, Kerala.

ii. Ujjivan SFB Limited, Bengaluru, Karnataka, (has 10,000 employees)

iii. Fincare SFB, Ahmedabad, Gujarat, has 25 branches spread over several states.

10. Payment Bank

Payment banks are formed to widen the spread of payment and financial

Indigenous bankers, Money lenders, Chit funds and Nidhi companies

1. Manusmriti, the ancient legal text reveals that different rates of interest existed during 2nd century BCE. Certain community based businessmen provided loans for interest in different parts of India. Today any individual as well as institution lend money in rural, and urban areas. *All of them are called indigenous bankers and money lenders*. They are not bankers at all. The report of the study group of RBI released in 2002 concludes that the loans from money lenders constitute 25.7 percent of the loans of farming household at all India level and 53.4 percent at Tamil Nadu level. The reasons for their indispensable existence are: a. They disburse loan at doorstep at any time of the day with or without security. b. They provide the required amount and at the required time. c. Very less documentation and procedures. d. Banks are not willing to advance loans to farmers or labourers with less income levels.

   Many lenders charge exorbitant rates as high as 20 percent per day. (1216 percent per annum). It is called 'kandhuvatti" or 'flight vatti" in Tamil. Such money lenders exist in other states of India and other countries also. The Usurious Loans Act 1918 of the Government of India and the Tamil Nadu Prohibition of Charging Exorbitant Interest Act 2003 prohibit charging such interest rates.
2. Under Tamil Nadu *Money Lenders Act*, 1957 license is issued by Tahsildars for money lending business. Pawn brokers obtain license under Tamil Nadu Pawn Brokers Act, 1943.
3. *Chit Fund* Act 1982 is applicable to chit funds (a type of savings scheme) throughout India. They are regulated by State Governments and not by the RBI.
4. *Nidhi Companies* promote thrift and savings habit among members and they are registered under Companies Act, 2013. Only Nidhi companies fulfilling certain norms are registered and regulated by the RBI. Others not regulated.

All the above are not banks recognized by the RBI as such and do not come under strict controls of the RBI.

services to small businesses, low-income households, and migrant labourers. These banks should be fully networked from the beginning. They offer doorstep banking payment for a small fees prescribed on the basis of the amount. They issue ATM/ debit cards, internet banking and third party fund transfers. They can't lend money and issue credit cards. In August 2015, the RBI gave 'in principle' licenses to Payment Banks.

Examples:

i. Airtel Payment Bank Limited

ii. Paytm Payment Bank Limited and

iii. India Post Payment Bank Limited - IPPBs (Public Sector Bank).

11. Multilateral Development Banks - MDBs

A Multilateral Development Bank is formed by the Governments of a group of countries.

The member countries consist of developed donor countries and borrower countries. International Bank for Reconstruction and Development, Asian Development Bank, African Development Bank, and European Investment Bank are some of the MDBs.

B. Based on the Status given by the RBI

Scheduled Banks and Non Scheduled Banks

All banks which satisfied the norms and included in the Second Schedule to the RBI Act, 1934 are called scheduled banks. Such banks are given financial accommodation and remittance facilities at concessional rates by the RBI.

India needs Large Sized Banks

Industrial and Commercial bank of China is the first ranked bank in the world with an asset size of USD 3,893.23 billion. Punjab National Bank, the largest nationalised bank in India has an asset base of USD 100 billion and its rank is 717. SBI a public sector bank merged with its five associates and BharatiyaMahila Bank with effect from April 1, 2017 and after merger its asset size is USD 573 billion (₹37 trillion). This will boost it among the top 50 banks (SBI earlier rank 272). National Bank of Australia has an asset base of USD 578.46 billion and it's rank is 49. To compete with large sized banks in the world India needs more large sized banks. Therefore merger of many nationalised banks is under consideration.

There is no non-scheduled commercial bank (private sector, public sector and foreign banks) in India. There are five Urban Cooperative Banks and three Local Area Banks which function as non-scheduled banks in India. Small Finance Banks and Payments Banks have not been licenses under Section 22 of the Banking Regulation Act, 1949.

C. Based on the Ownership Pattern

Any bank in which not less than 51 percent of shares are owned by the Government are called Government banks or public sector commercial banks (Total 21). All nationalized banks (19 banks, in 2017), SBI and IDBI Ltd. are public sector commercial banks. All of them are joint stock company type banks. There are corporation type banks. Each corporation type bank is established by a separate Act of Parliament and is fully owned by Government of India.

Examples:

IFCI, SIDBI, EXIM Bank, etc.

All banking companies owned by private people are called private sector commercial banks. All cooperative banks are owned by its members from the public.

1n 1969, there were 14 private banks which were concentrated in cities and towns. Their objective was to earn more profits. In order to channelize the funds with these commercial banks towards national priorities and to develop agricultural and rural sector nationalization of banks was undertaken. Government paid the share capital of those banks to the private owners and took over as Government banks. This is called nationalization of banks. 6 more

Banking Correspondents

Banking Correspondents (BCs) are retail agents engaged by banks for providing banking services at low cost in locations other than a bank branch/ATM. They are not separate banks recognized by the RBI. BC model was introduced by the RBI in 2006 to provide services at door steps. Non-Governmental Organisations or individuals like ex-serviceman can apply for BCs. The banks engaging BCs are responsible for their functioning. A bank in a country can appoint another bank in a foreign country to act as correspondent bank.

Banking Systems

1. There are several types of banking systems which can be combined by any of the above banks. They are: Unit banking, branch banking, retail banking, merchant banking, universal banking, relationship banking, wholesale banking, pure banking, mixed banking, chain banking, group banking, green banking and so on. These are not separate banks recognised as such by the RBI.

2. Islamic banking is a system of banking based on Islamic principles of banking or Sharia. It is based on two principles. First no interest is charged on loans and no interest is given ondeposits. The business firms which received loans from banks will give a share of profit to the banks and banks will give a share of profit to the depositors. It is practiced in UAE, Qatar, Pakistan, Kuwait, Bahrain, etc.

banks were nationalised in 1980. New Bank of India one of the nationalised bank merged with Punjab National Bank in 1980 and today there only 19 nationalised banks (2017). Examples:

a. **Nationalised Banks:** Indian bank, Indian Overseas Bank, Oriental Bank of Commerce.

b. **Public Sector Banks:** State Bank of India, IDBI Bank Ltd. and all nationalised banks

c. **Private Sector Banks:** Lakshmi Vila Bank, Karur Vysya Bank, Kotak Mahindra bank.

Note: Bharatiya Mahila Bank was established on 19, November 2013 to serve exclusively women members of the public was merged with SBI on 31 March, 2017.

A detailed study on the functions of commercial banks is given in the next chapter.

On the basis of organisation the banking may be unit banking or branch banking. On the basis of lending practices, it may be pure banking or mixed banking. On the basis of their products it can be retail banking or wholesale banking. On the basis of activities undertaken it may be narrow banking or universal banking. From the ownership point of view it can be chain banking or group banking. There are some peculiar types of banks such as investment banking, Islamic banking, etc. In modern times virtual banking or internet banking and mobile banking are very popular.

Key Terms

Nationalisation

Banking correspondent

Indigenous Banker

Multilateral Development Bank

For Own Thinking

1. Debate about the benefits of various banks
2. Bank visit - write an essay about the bank you visited
3. When you want loan how will you get the loan from bank?

For Future Learning

1. Mention the names of Commercial Banks, Industrial Banks, Co-operative Banks and Foreign Banks in your areas ……………………………..
2. Collection of pictures related to different types of banks

Case Study

1. You are the Agricultural bank manager; a farmer approaches you for loan from your bank for purchasing a tractor and other farm equipment.How would you sanction the loan?
2. Due to natural calamities, the farmer could not repay the loan. He has no other way to repay the loan. How to collect loan from the farmer?

Exercise

I. Choose the Correct Answer

1. Which bank is not a Industrial Bank?

(a) ICICI

(b) HSBC

(c) SIDBI

(d) IDBI

2. The Local Area Banks are promoting

(a) Rural savings

(b) Business savings

(c) Industrial development

(d)Agricultural development

3. Foreign banks are begun their operation since

(a) 1978

(b) 1979

(c) 1980

(d) 1981

Answer

1. (b) 2. (a) 3. (c)

II. Very Short Answer Questions

1. Give the meaning of Commercial Banks.
2. What do you mean by Industrial Banks.
3. What are Foreign Banks?

III. Short Answer Questions

1. Write a short note on Local Area Banks. Give two examples.
2. What are the objectives involved in Regional Rural Banks?

IV. Long Answer Questions

1. Explain the various types of banks based on the Functions.(any 5)
2. Explain the types of banks based on Ownership pattern.

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UNIT III SERVICE BUSINESS - I

CHAPTER 12 FUNCTIONS OF COMMERCIAL BANKS

Learning Objectives

To enable the students to

i. understand the primary and secondary functions of commercial banks

ii. explain the diversified banking services

iii. describe the uses of debit, credit and smart cards

Functions of Commercial Banks

They render many valuable services. The important functions of the Commercial banks can be explained with the help of the following chart

12.01 Primary Funtions

The primary functions of a commercial bank are of three types. They are:

I. Accepting Deposits

II. Granting Loans and Advances.

III. Creation of Credit

I. Accepting Deposits

The basic deposit accounts offered by commercial banks are listed below. In these days banks compete with each other to attract customers by adding facilities to these deposit accounts. Broadly deposit accounts can be classified into demand deposits and time deposits.

A. Demand Deposits

These deposits are repayable on demand on any day. This consists of savings deposits and current deposits.

1. Savings Deposits

General public deposit their savings into this account. This account can be opened in one individual's name or more than one name. Section 25 companies also can open savings accounts. Business firms are not permitted to open savings account. The rate of interest allowed on this deposit is lower than fixed deposits. Interest is paid on the basis of the amount and number of days the amount remains credited in the account. The bank provides facilities like cheque book, ATM (Automated Teller Machine) card etc. There is limit on number of ATM card withdrawals from other bank ATMs only. A minimum balance should be maintained in this deposit account. Otherwise penal interest is charged. Beyond a number (20 or 60 leaves) cheque book is available for a fee. Nomination can be registered. Salary account is a type of savings account offered to salaried employees in which zero balance is permitted. Some banks offer overdraft facility. An account inactive for a long period will become dormant account.

2. Current Deposits

This account is suitable for business institutions. Individuals too can open this account. A higher minimum balance should be kept in this account. If not penal interest is charged. No interest is paid for the balance in this account. Some banks have started offering interest on these account balances. Banks may collect bank charges on this account. Overdraft (short term unsecured loan) facility is available to current account customers. There is no limitation on deposit of cheques or withdrawals from this account. Credit worthiness of current account business customers are shared among banks.

B. Time Deposits

They include fixed deposits and recurring deposits which are repayable after a period.

1. Fixed Deposits (FD)

Certain amount is deposited for a fixed period for a fixed rate of interest. FDR (fixed deposit receipt) is given to the depositor. Rate of interest is higher than savings account. On the date of maturity the principal along with interest for the fixed period is paid. A customer can obtain loan by depositing FDR. Pre-mature withdrawal of cash is also allowed for payment of penal charges and it carries no interest. Partial withdrawal also allowed. Fixed deposit period can be 1 month to 10 years. FD is also called term deposit

2. Recurring Deposits (RD)

Certain sum is deposited into the account every month for one year or five years or the agreed period. Interest rate is more than savings deposits and almost equal to fixed deposits. At the end of the period the deposited amounts along with interest are returned to the customer. Premature closing is allowed with a charge or deduction. It is ideal for persons having regular income to save and receive a lump sum. Any institution can open RD account. Minors or students also can open this account. Loan against this deposit is also provided by some banks.

Know Your Customer (KYC) Norms

KYC means "Know Your Customer". It is the general rule to be followed by banks to get information regarding the identity and address of the customers. This rule helps to ensure that banks' services are not misused. The KYC process is to be completed while opening accounts. These details should be updated periodically. A person willing to open a bank account, should submit a 'proof of identity and proof of address' together with a recent photograph.

Six documents have been notified by the Government of India as 'Officially Valid Documents' (OVDs) for the proof of identity. They are Passport, Driving Licence, Voters' Identity Card, PAN Card, Aadhar Card issued by UIDAI and NREGA Job Card. The person should submit any one of these documents as proof of identity. If such documents also contain his/her address details, then it will be accepted as 'proof of address'. If not, then another officially valid document which contains address details need to be submitted.

II. Granting Loans and Advances

The second primary function of commercial banks is lending money in order to earn interest income. Banks provide specific sums as loans which are repayable along with interest. Demand loans should be repaid whenever demanded. Term loans can be repaid after the agreed period. Advances are credit facilities provided for short period (within a year) to business community. But both terms are used interchangeably.

A. Advances

1. Overdraft

It is a credit facility extended mostly to current account holding business community customers. It is an arrangement reached between the banker and the credit worthy customers. Such customers are allowed to overdraw (when there is no balance money in the account) up to a certain amount usually for 3 months period. It may be extended for further periods. Only on the withdrawn amount of credit interest is charged and not on the maximum limit allowed. It is an unsecured credit. Secured overdraft against the security of financial instruments is also provided by some banks. It is repayable on demand.

2. Cash Credit

It is a secured credit facility given mostly to business institutions. Stock in hand, raw materials, other tangible assets, etc. are provided as collateral. A certain sum is allowed as credit for a short period. Interest is payable on the actual amount withdrawn and not on the entire credit facility. . It is repayable on demand.

3. Discounting of Bills

Business customers approach banks to discount the commercial bills of exchanges and provide money. It is a short term credit instrument. Banks deduct the discount (interest) for the period mentioned in the bill and release the balance amount to the traders. If the bill is dishonoured, the bank can recover the amount from the customer. It is a form of unsecured credit.

B. Loans

Short term and medium term loans are provided by commercial banks against eligible collaterals to business concerns. It is a definite sum of money lent for a definite period. It is repayable in one lump sum or in instalments. Interest is payable on the entire loan amount. Every bank in these days design new methods of advancing loans to find more ways of learning income. Generally commercial banks provide the following loans.

1. Housing Loan

Taking the title deeds of the house as collateral security, based on the monthly income of the borrowing customer, banks advance medium and long term loans. The customer repay the loan in equated monthly instalments (EMI consists of principal and interest). This is a boon to the middle class salaried employees who cannot afford to pay the full price of a house in a lump sum.

2. Consumer Loan

Consumer durables like refrigerator, air conditioner, laptop, washing machine, television, etc. can be purchased by customers with consumer loans from banks. The product purchased is hypothecated (secured loan arrangement where the movable asset remains with the borrower) as security for the consumer loan amount. The customer pays in equated monthly instalments for a specified period.

3. Vehicle Loan

Two wheelers, cars, buses and other vehicles can be purchased by individuals as well as institutions obtaining vehicle loans from the banks. Vehicles are hypothecated to the bank until the entire loan amount is repaid. Vehicle registration book is deposited with the bank and on full payment of loan amount it will be handed over to the customer.

4. Educational Loan

Loan is provided by banks to students for studying undergraduate, post graduate or professional courses. Loan may be received in instalments to pay the educational fees every year. After completion of the course one year is allowed for the student to get employed. Afterwards, the student should repay the loan with interest for the entire period. Interest is charged from the date of first instalment of loan amount payment.

5. Jewel Loan

Customers pledge their gold jewels and obtain loans from banks. The margin (percentage of value per gram that can be given as credit) requirement is fixed by the RBI. Interest should be paid every month. Otherwise interest on interest is charged. Within 12 months the customer can redeem or else can re-pledge. Jewels not redeemed even after reminders are sold in auction by banks to recover their dues.

III. Creation of Credit

Apart from the currency money issued by the RBI, the credit money in circulation created by commercial banks influence economic activities of a country to a large extent. Credit money of commercial banks is far greater in volume than the currency money. The volume, the purposes and the sector to which this credit money is to be channelised - all these are implemented by commercial banks under the guidance of the RBI.

According to 2011 data, the credit created by all Indian commercial banks was 75.1% of GDP. It was 233.3 % in the USA, 145.5% in China, and 340.9% in Japan.

12.02 Secondary Functions

Apart from the basic or primary functions commercial banks render various other services which are known as secondary functions. These services can be broadly classified into agency services and general utility services.

I. Agency Functions

Banks act as agents of customers and provide certain services. They are called Agency Functions which are as follows:

1. Transfer of Funds

Banks issue demand drafts, bankers' cheques, travelers' cheques, etc. and help in transfer of funds from one place to another. Customers need not carry cash. They can just forward the draft issued by the bank to the receiving institution. A small commission is collected by banks for this service.

2. Periodic Payment of Premiums, Rent, etc.

After instruction from the customers, banks undertake the monthly payment of insurance premium, rent, telephone bill, etc. from the accounts of customers. Now a days these payments are made through electronic clearing system facility offered by the banks.

3. Collection and Payment of Cheques

On behalf of customers bank collect the cheques deposited into the accounts of customers from other banks and deposit cash in the customers' accounts. Similarly cheques issued by a customer is honoured and the amount paid as directed by the customer.

Definition of Cheque: According to Negotiable Instruments Act 1881, "cheque is a bill of exchange drawn on a specified banker payable on demand".

Crossing of Cheque: Drawing two parallel transverse lines on the left top of the cheque. It implies that the money will not be paid over the counter but through bank account only.

4. Acting as Executors, Trustees and Attorneys

Banks act as executors of will of the customers and implement their will after their death. As a trustee a bank takes care of the funds of the customers. Banker signs transfer deed of the properties of the customers in the capacity of attorney to customers.

5. Conduct Share Market Transactions

A Demat account should be opened with Depository Participant and that demat account should be linked with savings bank account by the customer. Then the customer can ask the bank to conduct online purchase or sale of securities, on behalf him.

6. Preparation of Income Tax Return

Banks prepare the annual income tax return on behalf of the customers and provide income tax related advices to them.

7. Dealing in Foreign Exchange

Banks buy and sell foreign currencies on behalf o customers.

8. Acting as Correspondent

Banks act as correspondent of customers and receive travel ticket, passport, etc.

II. General utility functions

In addition to primary, secondary and agency functions, commercial banks offer some services for the general welfare of the customers. They are called general utility services. They are as follows.

1. Issue of demand drafts and bankers' cheques

Demand drafts and Bankers Cheques are issued to public and customers as well. Instead of sending money they can attach these instruments for payment of educational fees, etc.

2. Accepting Bills of Exchange on behalf of Customers

Banks accept bills on behalf of customers and make payments to the foreign exporter. Afterwards, the banks collect from the customers.

3. Safety lockers

Valuable documents, jewels, etc. can be kept safely in a vault provided by bank for a rent. These vaults room is called 'Strong Room'.

4. Letters of credit

This document is given by bank on behalf of importing customer to the exporter guaranteeing payment for the imported goods. It is a very important document in international trade.

5. Travellers cheques

Customers need not carry cash during travel in India or abroad. The denomination and words are printed in the cheque. It is accepted as money in shops, hotels, travel agencies, etc.

6. Gift cheques

These denomination printed cheques are available in attractive design so that it can be presented during wedding, birthday functions, etc.

7. Reference service

Business firms can give their bank's name as reference to the new business institution with which they want to establish commercial relationship. Banks willingly act as referees and provide information about the financial standing of their customers.

12.03 Diversified Banking Functions

Competition in the banking industry has reduced their profits. Therefore the commercial banks started identifying and offering new and diversified financial services. They are purely other than banking services. Providing all such banking and other financial services is also called universal banking. Such services are as follows:

1. Bank Assurance

It refers to the offering of insurance policies or products by a bank in association with another insurance company. Banks should follow Insurance Regulatory and Development Authority of India (IRDA) regulations in addition to RBI regulations. Corporation Bank, Oriental Bank of Commerce and Vijaya Bank has tied up with Life Insurance Corporation of India. SBI has joined hands with BNP Paribas Cardif - a French company to sell insurance products.

2. Merchant Banking

Merchant banks do not provide regular banking services. A commercial bank or its subsidiary merchant bank may offer services like project counselling, underwriting, etc. required for starting a company. It is called merchant banking. They are mostly stock market related services. Merchant Banks are controlled by Stock Exchange Board of India (SEBI) regulations also.

3. Retail Banking (Personal Banking)

It refers to mass market banking which reaches out to large number of individual end customers. Apart from accepting deposits, their services include personal loans, vehicle loans, consumer durable loans, loans against equity shares, debit and credit cards, mortgages, etc.

4. Housing Finance

Housing finance is provided against the security of immovable property of land and buildings. Many banks such as SBI, Bank of India, etc, have set up housing finance subsidiaries.

5. Mutual Fund

It is a financial intermediary that pools the savings of investors for collective investment in diversified portfolio securities in the capital market and money market. Many banks like SBI, Indian Bank, etc, have set up mutual fund subsidiaries.

6. Venture Capital Fund

Venture capital fund provides start-up share capital to new ventures of little known, unregistered, risky, young and small private business, especially in technology oriented and knowledge intensive business. Many commercial banks like SBI, Canara Bank, etc. have set up venture capital fund subsidiaries.

7. Factoring

Factoring is a continuing arrangement between a financial intermediary (factor) and a business concern (client) whereby the factor purchase the clients' accounts receivable. Banks like SBI and Canara Bank have established subsidiaries to provide factoring services.

12.04 Electronic Banking Functions

This reduces cost and time and makes banking service convenient to the customers. It is operated through internet. This service is a substitute for drafts, cheques and other paper based transfer of funds.

1. NEFT - National Electronic Funds Transfer

This was launched by the RBI in 2005. Under this electronic funds transfer system, bulk transfer of transactions are settled in batches during specific timings across India. Individuals and institutions which maintain accounts with a NEFT enabled bank branch are eligible for using NEFT. Transactions do not occur under real time basis. Once in every half hour from 8.00 am to 7.30 pm. 23 settlements are allowed in a day.NEFT transfers are not allowed on Sundays and bank holidays. Both NEFT and RTGS use IFSC (Indian Financial System Code) - a 11 digit alphanumeric code, to identify a bank branch. IFSC is provided by IDRBT (Institute for Development & Research on Banking Technology), Hyderabad.

2. RTGS - Real Time Gross Settlement Systems

It was launched by the RBI in 2013. The transactions are settled on real time basis. Gross settlement means the transaction is settled between one bank and another bank without adding any other transactions. RTGS facility is available between 9.00 am to 4.30 pm on weekdays and up to 2.00 pm on Saturdays. In one day the RTGS routes about 60,000 transactions worth about ₹2,700 billion and covers over 52,000 bank branches located in 10,000 cities and towns. RTGS transfers are not allowed on Sundays and bank holidays. Minimum limit for RTGS transaction is 2 lakhs.

3. Electronic Clearing Services (ECS)

ECS was launched by the RBI in 1995. It is an electronic method of fund transfer from a bank to another bank. ECS credit can be used to credit salary, dividend, interest, pension etc. and ECS debit is used to debit monthly telephone bills, electricity bills, equated monthly installments (EMI) payments. For this purpose the account holding individuals and institutions concerned should fill up certain forms and submit to the banks. ECS transactions between banks are settled in the current account maintained in the clearing house.

4.CORE Banking Solutions

'CORE' stands for 'Centralized Online Real time Exchange'. In the centralized server of the bank, all the details of all the accounts of all the branches of the bank are available. A customer can withdraw money through cheque at any branch of that bank throughout the world. Similarly anyone can deposit money into the account. Entry of the transactions is recorded in the centralized server of the bank in real time and can be seen in all the branches of the bank. This facility is called core banking solutions.

5. Internet Banking or Virtual Banking

Internet banking refers to performing banking operations through internet, using computers and mobile phone. This can be done by a customer from home or office or any part of the world and all 24 hours of 7 days.

6. Mobile Banking

Most of the commercial banks have designed computer programs called apps which can be downloaded in smartphones. With this app in the smartphone a customer can operate his account transactions from anywhere. This service is known as mobile banking.

7. Automated Teller Machine (ATM) and CDM Facilities

A customer can withdraw money anytime, anywhere in India from the ATM machine using the ATM card given by his/her bank. The machine also shows the balance available in the customers' account, provides statement print of the few past transactions, etc. Withdrawal of money in other bank ATMs is restricted and will be charged beyond the specified number of usage. Cash Deposit Machine Facility is useful to the public as well as customers to deposit cash into the account anytime. Similarly there are cheque deposit machines which receive cheques at any time.

8. IMPS - Immediate Payment Service

IMPS was launched by the National Payments Corporation of India in November 2010. IMPS allows funds transfer through mobile phone or internet banking by banking customers and approved non-banking partners. Its transactions are on real time basis. The current maximum limit is ` . 2 lakhs. It made India a leading country in the world in real time payments in retail sector.

9. Funds Transfer Through SMS

*99# is the number for the funds transfer from any mobile phone. It was launched in 2014. Every common man in India can transact banking transactions from any corner of India.

NACH, BBPS, BHIM

National Automated Clearing House founded in 2008 is a web based solution to facilitate interbank high volume electronic transactions which are repetitive and periodic in nature. It will be helpful for banks, financial institutions, Corporates and Governments. It is a centralised system that aim at consolidating multiple ECS systems running across the country and removing local barriers.

Bharat Bill Payment System is a RBI guided system operated by National Payments Corporation of India from August 2016. It is a one stop payment platform for all bills providing anytime anywhere bill payment service to all customers across India with certainty, reliability and safety of transactions.

Bharat Interface for Money is an app that lets a bank customer make simple, easy and quick payment transactions using Unified Payments Interface (UPI). A bank customer can make instant bank to bank payments and pay and collect money using just mobile number or virtual payment address (VPA). It was launched in December 2016.

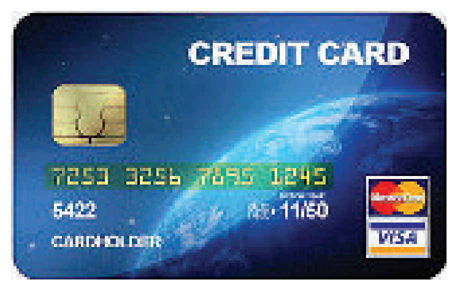
10. Debit Cards

ATM card is also called debit card. This card is more useful in purchase of goods and services anywhere in India, if the shop maintains a swiping machine facility. VISA card and Maestro card services are offered by Visa Corporation and Mastercard both from the USA. RuPay cards services were launched in March 2012 by the National Payments Corporation of India.

11. Credit Cards

Banks issue credit cards to customers and other eligible persons. With this card, the holder can purchase goods and services on credit at any shop in India. If the dues are paid within the stipulated time no interest is charged. The credit limit is fixed by the issuing bank based on the income of the cardholder.

12.05 Functions of All Commercial Banks in Totality



All commercial banks put together perform certain functions to the development of the country's economy.

1. More production and economic growth

These banks supply the vitamin money to all sectors of the economy including manufacturing sector. As a result all the sectors produce more.

2. Capital formation

Banks encourage savings habit among people and accumulate their small dormant savings. These funds can be fruitfully channelized for productive purposes of the economy.

3. Consortium finance

Thousands of crores required to establish a mega factory is not available from a single source. Banks join together and provide consortium finance in such cases.

4. Service coverage to non-monetised sector

Branches of the banks are opened in rural and village areas so that the non-banking areas are provided banking services.

5. Balanced regional development

Banks transfer funds from surplus areas and make them available in scarce districts or areas for the formation and operation of business institutions. Even growth of different regions can be achieved through this function.

6. Smoothing of trade and commerce

For the efficient functioning of all traders and business institutions in a country, safe keeping of their funds, transfer of funds, payment and collection of funds when and where needed is very much necessary. Banks perform this function.

7. Development of industry, agriculture, MSMEs and SHGs

Banks design methods and instruments of financing each sector differently. They provide finance for small farmers, medium traders as well as industries. For example banks allow micro credit to SHGs, overdraft to traders and issue Certificate of Deposits to finance industries.

8. Implementation of monetary policy

Banks have established customer relationship with all public and business institutions through the network of branches. Broad guidelines or rules of the Government for the monetary sector of a country cannot be applied without such banks.

9. Encourages export and international trade

Banks open foreign branches or establish correspondent relationship with banks in foreign countries to help exporters. Instruments like letters of credit and international factoring services are undertaken to help exporters and importers.

10. New entrepreneurs and employment opportunities

Entrepreneurs obtain project loans and establish new business houses. By providing the required credit banks generate more economic activities and new employment opportunities.

Key Terms

Deposits, Loans, Electronic, Debit card, Credit card, Smart card, Core banking

For Own Thinking

In all ATM Centers, there are one or two machines, sometime it may be four or five. All ATM machines have some amount of money inside the box. In this way lot of currency notes are locked day by day. Think about the alternate way for avoiding this locking of currency notes.

Debate about the security problem in E-Banking system of services.

For Future Learning

Field visit - nearest -collect information about rate of interest payable on Savings deposit, Fixed deposit, Current deposit and Recurring deposit.

Collect photo copies of the various cards used in our day- to-day life.

Nowadays debit card, credit card, smart cards and other cards are used for day to day purposes. In future how many cards we may use for our purposes.

Case Study

A person forgot his password of Debit card, How to get password? Give guidelines to him.

Exercise

I. Choose the Correct Answer

1. Electronic banking can be done through

   (a) Computers (b) Mobile phones

   (c) ATM (d) All of the above

2. Minimum how much amount can be transferred through RTGS?

   (a) Any amount (b) 50,000

   (c) 2 lakh (d) 5 lakh

3. The largest commercial bank of India

   (a) ICICI (b) SBI

   (c) PNB (d) RBI

4. In which kind of account, it is compulsory to deposit certain amount at certain time?

   (a) Saving deposit

   (b) Fixed deposit

   (c) Current deposit

   (d) Recurring deposit

5. Which of the following is not a type of advance provided by commercial bank?

   (a) Collecting and supplying business information

   (b) Overdraft

   (c) Cash credit

   (d) Discounting of bills

Answers

1. d 2. c 3. b 4. d 5. a.

II. Very Short Answer Questions

1. What is Mobile Banking?
2. Write a short notes on Debit card.
3. Write a short notes on Credit card.
4. What do you mean by ATM?

III. Short Answer Questions

1. What is E-Banking?
2. Write a short note on – RTGS.
3. Explain – NEFT.

IV. Long Answer Questions

1. Discuss the various primary functions performed by the Commercial Banks. (any 5)
2. Explain the various secondary functions of Commercial banks. (any 5)

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UNIT III SERVICE BUSINESS - I

CHAPTER 13 WAREHOUSING

Learning Objectives

To enable the students to

i. know the meaning of warehouses and warehousing.
ii. explain the different types of warehouses.
iii. describe the functions of warehouses.
iv. know about the various warehousing documents.

Introduction

The term "Ware" means products or goods. "Warehousing" generally means storage place or godowns which is located near a factory to keep the raw materials and finished products. Storage is only a holding place of goods. Whereas a warehouse is located near the market to perform the other marketing functions such as grading, standardization, blending, mining packing, etc. The development of science and technology has improved the ways and means of storage. It removes the hindrance of time.

13.01 Meaning of Warehouse and Warehousing

Warehouse

It is a place where goods are stored for future use and act as distribution centres. Warehouses are designed depending upon the nature of the products to be stored.

For example, to keep perishable items like fruits and vegetables, cold storages are required. Certain pharmaceutical products are to be kept under suitable temperature. Liquids like petrol, oil molasses need tanks while grains like barley, pulses, etc. need ventilated halls.

According to J. Stephenson, "a warehouse in an establishment for the storage or accumulation of goods".

Warehousing

It is an arrangement by which goods are stored when they are not needed immediately and are kept in such a manner so as to protect from damage or deterioration.

"A warehouse is a commercial building for storage of goods. Stored goods can include any raw materials, packing materials, spare parts, component or finished goods associated with agriculture, manufacturing and production".

13.02 Differences between Warehouse and Warehousing

Warehouse is a place where goods are stored for future use whereas, warehousing is an arrangement of goods. Warehouse is to hold goods for storing purpose only.

Warehousing object is to preserve and protect the goods from deterioration in quality and quantity.

Need for Warehousing

(a) Mass production

Production is based on the anticipated demand for goods. Mass production of goods takes place by establishing big factories and modern production. The market for such goods is spread all over the country. Therefore, warehouses are to be built at different places to store these products and provide prompt supplies when demanded.

(b) Nature of commodities

Some goods are perishable in nature and therefore it should be consumed in time to avoid deterioration. Storing them in cold storages can extend the life of the goods.

(c) Seasonal production but regular consumption

The farm products such as wheat, sugar, pulses, etc. are produced only in seasons. But the consumption of these products are evenly spread throughout the year. If proper storage facilities are not provided, the quality of these goods deteriorates and may become not usable.

(d) Regular production but seasonal consumption

Certain goods are produced regularly throughout the year. Bu they are demanded in seasons only. For example, rain-coats, blankets, umbrella, etc. require storage for whole year. They can be released in large quantities to meet the heavy demand in rainy and winter seasons.

(e) Proximity to production centers

Productions of goods at specific centers need to be supplied in time and without interruption to consumers throughout the country. For this purpose goods are regularly fed to the warehouses situated at different market areas.

13.03 Types of Warehouses

Warehouses can be classified as follows:

A. On the Basis of Ownership

(a) Private Warehouses
(b) Government Warehouses
(c) Public Warehouses
(d) Co-operative Warehouses
(e) Bonded Warehouses
(f) Institutional Warehouses
(g) Distribution Centre Warehouses

B. On the Basis of Commodities Stored

(a) General Warehouses
(b) Special Commodity Warehouses
(c) Cold Storages or Refrigerated Warehouses
(d) Climate Controlled Warehouses

A. On the Basis of Ownership

a. Private Warehouses

Private warehouses are built and owned by private business enterprises in order to store the products produced by them. They are exclusively for their use and are not meant for other manufacturing or business units.

b. Government Warehouses

They are created and operated by the Government to implement the programmes of the Government. Their services mostly available to government only. A detailed study on all the above warehouses is given at the end of this chapter.

c. Public Warehouse

It is open for public at large. Most of the business organisations, especially small and medium scale units cannot afford to have their own warehouses. They may be owned by an individual or some agency. These warehouses operate as per the rules and regulations formed by the Government.

d. Co-operative Warehouses

There are warehouses owned and managed by the marketing co-operative societies or agricultural co-operative societies. They are set up to provide warehousing facilities to their members. Example, National Co-operative Development Corporation (NCDC).

e. Bonded Warehouses

Bonded warehouses are those warehouses, which are licensed by the government to accept storage of imported goods which are not cleared due to non-payment of customs duty by the importer. Branding can be undertaken in the warehouse itself. Bank loans can be obtained by submitting the receipt issued by these warehouses as collateral security. Strict supervision and control is imposed by custom authorities on their operation and functioning.

f. Institutional Warehouses

Different institutions and bodies have their own warehouses on account of the nature of their operations. For example, Banks, Railways, etc, have their own warehouses for conducting their activities. Various transport agencies also maintain warehouses for storing the goods which are to be despatched and received.

g. Distribution Center Warehouses

Goods which need to be temporarily stored for one or two days so that they can be distributed to other offices or customers are stored in Distribution Centers. They are owned by the manufacturer or wholesalers.

B. On the Basis of Commodities Stored

a. General Warehouses

They are ordinary warehouses which are useful for storing most of the dry food grains, fertilisers, etc. Protective measures against rat, insects, etc. are undertaken by them.

DO YOU KNOW?

Village Storage or Warehouse

Underground storage structures are used by farmers in villages to store food grains. They are safer from threats from various external sources of damage, such as theft, rain or wind. Separate peripheral structures with mud are erected as surface storage structure for food grains. PAU bin, Pusa bin, HapurTekka, etc. are used for small scale storage of grains. Cap storage, Silos, etc, are used for large scale storage of food grains.

b. Special Commodity Warehouses

These warehouses are specially constructed for storing specific type of commodities like tobacco, cotton, wool etc. These warehouses reduce loss of quality and quantity to a great extent. Storage of petrol and oil requires special type of vertical, cylindrical storage tanks.

c. Cold Storages or Refrigerated Warehouses

Goods are transported in refrigerated containers and stored in refrigerated warehouses. These warehouses are used for storing perishable goods like fruits, vegetables, eggs, butter, fish, meat, etc. Goods stored in cold storages without deterioration in quality, can be made available throughout the year.

d. Climate Controlled Warehouses

The controlled climate environment can reduce the rate of metabolism in fruits and vegetables. Humidity controlled environments for delicate products such as flowers in dirt-free facilities in these warehouses.

e. Automated Warehouses

Automated facilities which can handle several hundreds of kilograms of product at a time. Inside the warehouse premises physical distribution activities are carried out by moving product filled pallets (i.e. platforms that hold large amounts of product). It requires huge investment, latest technology and large turnover of goods.

13.04 Functions of Warehouses

Warehouses render invaluable services to the society by performing the following functions:

(i) Storage

There is a time gap between the time of production and the time of consumption and a gap between demand and supply. The surplus goods are stored properly for the purpose of supplying them at right place and the right time.

(ii) Price Stabilization

Warehousing ensures price stabilization by supplying goods as and when demanded. It acts as a cushion to absorb price fluctuations and supplies the goods at more or less uniform prices throughout the year.

(iii) Equalization of Demand and Supply

Warehousing equalizes the demand and supply of goods by storing thee goods when they are not demanded and releasing them

DO YOU KNOW?

Warehousing Development and Regulatory Authority(WRDA)

To develop and regulate the warehousing industry in India, Warehousing Development and Regulatory Authority was established under the Warehousing (Development and Regulation) Act, 2007. Its objective is to improve the storage capacity in the country and also help producers, farmers and consumers get a better deal by cutting the intermediaries and wastages.

when there is a demand. Thus the consumers get the commodities regularly even during the off-season periods.

(iv) Business Finance

Based on the goods deposited in a warehouse, the depositor can get finance from banks and other financial institutions by showing the receipt issued by the warehouse keeper.

(v) Risk bearing

In case of damage to the goods, warehouse keeper compensates the loss caused to the owner of the goods. Thus, warehouses bear the loss of risk involved in storage of goods.

(vi) Preparation for sale

Modern warehouses undertake the functions of sorting, packing and labelling for the purpose of making the goods suitable for marketing. Hence warehousing is needed for making the goods suitable for sale.

(vii) Widening the marketing area

A manufacturer can sell the goods to different marketing areas by establishing branch warehouses or taking the service of rental warehouses at the required places. Thus warehousing widens the market for the goods.

(viii) Value added services

Warehouses also provide certain value added services, such as in transit mixing, grading, packaging and labelling. Sometimes, goods are repacked and labelled again at the time of inspection by prospective buyers.

What is in Transit Mixing?

It refers to a function in which warehouse receives products from different plants and mix and repack them as per client's requirement.

13.05 Advantages and Drawbacks of Warehousing

Advantages

1. It safeguards the stock of the merchants who do not have storing place.
2. Warehouses reduce distribution cost of the traders by storing the goods in bulk and allow the trader to take the goods in small lots to his shop.
3. It helps in selection of channel of distribution. The producer will prefer whether to appoint a wholesaler or retailer.
4. It assists in maintaining the continuous sales and avoids the possibilities of "out of stock" position.
5. It creates employment opportunities for both skilled and unskilled workers, to improve their standard of living.

Drawbacks of Warehousing

Warehousing is not effective because of the following reasons:

1. There are no adequate transport facilities between the place of production and warehouses.
2. Lack of sufficient storage facilities for different commodities such as perishable and non-perishable commodities.
3. Complicated formalities are to be fulfilled at the warehouses. The illiterate and innocent farmers are not able to cope with these procedures.
4. Complicated process of Barcode technology can reduce the storing of goods by some producers.

5. Unavoidable delay for obtaining financial assistance may cause loss to the owner of goods.

13.06 Warehousing Documents

The following documents are used in connection with the warehousing.

a) Warehouse Warrants

It is a document issued in favour of the owner or depositor of goods by the warehouse keeper. This is a document of title of goods and can be transferred by simple endorsement and delivery. To transfer all the goods the warehouse warrant is sufficient. If only a part of the goods are to be transferred then delivery order is needed. The delivery order is to be accompanied by the warehouse warrant.

b) Warehouse Keeper's Receipt

It is a document issued by the warehouse keeper, which acknowledges the receipt of goods from the depositor of goods. It also shows the existence of an agreement to keep the goods in the warehouse subject to certain conditions. This is not a document of title of goods and is not transferable.

c) Dock Warrant

Dock is a place in the harbor where the goods are kept for loading into the ship. Dock warrant is a document of title of goods issued by dock authorities. This document certifies that the dock authorities hold the goods. To take delivery of the goods this certificate should be given back to dock authorities. The right of getting delivery of goods can be assigned to third parties too.

d) Dock Receipt

Dock receipt is an acknowledgement of receipt of goods issued by dock authorities to the owner of the goods. It is not a document of title of goods. Therefore, the right of taking of delivery of goods cannot be transferred.

e) Delivery Order

This is a document through which the depositor directs the warehouse keeper to deliver the specified goods either to the party mentioned in the document or to the bearer. The warehouse keeper delivers the goods as per the instruction. Transfer of ownership

Differences between Warehouse Warrant and Warehouse Receipt

Warehouse Warrant	Warehouse Receipt
1.It is a document of title of goods	It is not a document of title of goods
2. It is not only an acknowledgement for the receipt of goods but also gives an authority to get delivery of goods by the owner orby third party.	It is only an acknowledgement for the receipt of goods.
3. It can be negotiated or transferred to others.	It cannot be transferred to others
4. It can be given a collateral security for getting financial assistance	It cannot be given as collateral security.
5. Delivery of goods effected by surrendering this warrant with endorsement	Delivery is effected by surrendering this receipt with letter from depositor.

takes place through this document.

13.07 Warehousing in India

India is an agrarian country but the importance of warehousing was not felt till 1950. Agriculture contributes 16 percent of the overall GDP and accounts for employment of approximately 52 percent of the Indian population. It is estimated that more than 40 percent of our agricultural productions wasted due to poor storage facilities.

On the recommendation of the All India Rural Credit Survey Committee, the Agricultural Produce(Development and warehousing) Corporation Act enacted in 1956, authorized the Government to setup National Co-operative Development and Warehousing Board to develop agricultural Co-operatives and warehousing.

Main Warehousing Agencies in the Public Sector

The three main agencies in the public sector engaged in providing large scale warehousing facilities are:

A. Food Corporation of India (FCI)

It provides storage facilities for food grains. Food Corporation of India also hires storage capacity from other sources such as Central Warehousing Corporation, State Warehousing Corporation and private parties. The available storage capacity of Food Corporation of India is 74.6 million tonnes. (August 28, 2013 Government told in Lok Sabha). The FCI was set-up under the Food Corporation Act 1964, in order to fulfil following objectives of the food policy:

i. Distribution of food grains throughout the country for public distribution system.
ii. Effective price support operations for safeguarding the interests of farmers.
iii. Maintaining satisfactory level of operational and buffer stocks of food grains to ensure National food security.

B. Central Warehousing Corporation (CWC)

It was established in 1957. The available storage capacity of Central Warehousing Corporation is 11.17 million tonnes and with the operation through 464 warehousing centers across the country. (as on 30th September, 2017).

Functions of Central Warehousing Corporation:

1. To provide agency services for scientific storage of agricultural produce, seeds, manures fertilizers, agricultural implements and other notified commodities.
2. To issue a negotiable warehouse receipt for procuring credit to the owners of goods.
3. To preserve the produce deposited with care and protect against insects and various pests and deterioration due to moisture and dampness.
4. To act as an agent of the government for the purchase and sale, storage and distribution of specified commodities and transport to and from warehouse.
5. To reduce the cost of storage and facilitate the marketing of produce through proper grading.

C. State Warehousing Corporation (SWC)

Every state government is given power to establish its own Warehousing Corporation after getting approval from the CWC. 50% of the capital is contributed by the CWC and the balance 50% contributed by State Government.

D. Tamil Nadu Warehousing Corporation (TNWC)

It was established in 1959. The available storage capacity of TNWC is 6.83 Lakh MT with 7 Regional offices and 256 Godowns across the state. It is one of the biggest public warehouses operating in the state, offering logistic services to a diverse group of clients.

Key Terms

Warehouse, Warehousing, Bonded warehouses, Warehouse warrant, Dock warrant. Dock receipt, Food Corporation of India, CWC – Central Warehousing Corporation.

For Future Learning

The warehouse of the future: How will it impact efficiency?

From 2019, new technology could be revolutionary and improving efficiency in warehouse by Warehousing Management System (WMS). Technologies including artificial intelligence, 3D printing and self-driving vehicle could be more widely used in warehouses everywhere sooner than you think. By 2030, warehouses will be a part of initiative to achieve Zero net energy.

Warehouse buildings will operate 24X7X365 and be designed with sustainability. By creating strategies, warehouse will save costs and prevent harmful emissions. Solar panels will become the main sources of energy for warehouses.

ETSKU

Exercise

I Choose the Correct Answer

1. Warehouses remove the hindrance of ______________

a) Person

b) Time

c) Risk

d) Knowledge

2. **A warehouse holds goods as a __________ center.**

a) Marketing b) sorting
c) distribution d) selling

3. **________can be given as a collateral security for getting financial assistance from bank.**

a) Dock warrant
b) Warehouse receipt
c) Dock receipt
d) Warehouse warrant

4. **____ warehouses are licensed by the government and are permitted to accept the goods on bond.**

a) Bonded b) Cold Storage

c) Public d) All the Above

5. **_________ warehouses are used for storing perishable goods like fruits, vegetables etc.**

a) Bonded b) Private
c) Cold storage d) Co-operative

Answers

1. b 2. c 3. d 4. a 5. c 6. c

II Very Short Answer Questions

1. What is Warehouse?
2. List the various types of warehouses.
3. Give any two functions of warehouses.
4. Give a note on FCI.

III Short Answer Questions

1. Differentiate the warehouse warrant from the warehouse receipt. (any 3)
2. Explain Cold storage warehouse.

IV. Long Answer Questions

1. Explain the different types of warehouses. (any 5)
2. Explain the advantages of warehousing.

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UNIT III SERVICE BUSINESS - I

CHAPTER 14 TRANSPORTATION

CWQJZ

Learning Objectives

To enable the students to

i. understand the different types of Transport
ii. explain the services of transport to business
iii. know the documents used in transport
iv. know about Common Carrier

Introduction

Transport service facilitates the smooth carriage of goods from the place of producer to the place of consumer. Transport also facilitates travelling of people from one place to another place. The different types of transport are given below.

14.01 Meaning and Definition of Transport

The term 'transport' includes all the clerical, mental and manual occupation involved in the operation of road, rail, canal, sea and air transport. Goods have no use unless they are made available at a place where and when they are wanted. Transport is an integral part of Commerce. It is a means to carry men and materials from one place (production) to another resulting in creation of place and time utilities. It removes the hindrance of place.

According to K.K. Sexena, "the transport system acts with reference to the area it serves in the same way as a candle does in a dark room".

14.02 Types of Transport

Transport system can be classified in different ways depending on the types of transport, the ways and means of transport and also the motive power used in transport.

A. Surface Transport

Transport of people and goods by land vehicles is known as Surface transport. It is also called as 'Land Transport'.

1. Pack Animals

Animals like horse, mule, donkey camel, and elephant etc., are used for carrying small loads in backward areas, hilly tracks, forest regions and deserts known as pack animals. Generally, the pack animals serve areas which are inaccessible to modern means of transport. Animal transport has also played a significant role where there is no road and railway transport.

2. Bullock Carts

It constitutes the predominant form of rural road transport in India for goods traffic and to some extent for passengers' traffic. It links up the villages with the nearby markets and railway stations. It carries the produce for sale to the market and consumer goods to the villages.

Pack Animals

Bullock Carts

Pathways Transport

It is the oldest form of transport found in hilly areas, forest areas and in remote places. These are used by human beings for transport.

3. Road Transport

Road Transport is one of the most promising and potent means suitable for short and medium distances. It provides the basic infrastructure for bringing the majority of the people who are living in far-off villages into the mainstream of nation like by connecting them to different places. It offers a number of advantages such as flexibility, reliability, speed and door-to-door service, besides supplementing and increasing the efficiency of the other modes of transport.

4. Motor Lorries and Buses

From the dawn of civilization, people have been endeavoring to form roads and use wheeled vehicles to facilitate transport of men and materials. The credit of revolutionizing the road transport and introducing the elements of speed and greater carrying capacity into the system goes to motor lorries and buses. Introduction of petrol engine and later diesel engine vehicle has been offering good competition to the railways.

5. Tramways

It made their appearance in the 19th century as a form of transport suitable for big cities. Tramways were initially horse drawn later steam-powered and now electrically operated. Its carrying capacity is large. They are able to cope up with the peak hour traffic in big cities with the greater popularity of motor buses, tramways slowly declined. Madras city had tramways till 1933.

6. Railway Transport

The invention of steam engine by James Watt, revolutionized the mode of transport all over the world. Railway, as a mode of transport is the most organized transport undertaking all over the world. Railways are the cheapest and quickest means of transport for carrying heavy goods over long distance.

Railways render an essential public service. It requires a huge capital outlay for laying

Tramways

Railways

Indian Railway is the largest Railway Organization in the world. The Indian Nationwide network, the 4th longest in the world, is owned and operated by State-Owned Indian Railways and includes an operating route length of more than 65,000 Kms. The network carried about 8 billion passengers (the highest in the world) in 2013.

of tracks, construction of bridges, purchase of locomotives etc. Railways are among the biggest public utilities of a country. Rail transport is a means of transferring of passengers and goods on wheeled vehicles running on rails (tracks). Rail transport stated to be important in the Industrial Revolution.

There are three types of tracks that are in operation. They are (I) Meter gauge (ii) Broad gauge and (iii) Narrow gauge

Advantages of Railway Transport

1. Railways are well suited for carrying heavy and bulky goods over long distances.
2. It can provide long distance travel throughout the day and night with unbroken services.
3. It can provide better production and safety to the goods than motor transport. The goods generally carried in closed wagons are not exposed to sun, rain etc.
4. Though initial investment is large, in the long run the operating expenses will be very low in railways and it will prove a cheaper mode of transport.

   It requires less time than motor transport for carrying goods over long distance with greater speed
5. It has regular schedule of timing and is available throughout the year.
6. It provides unaffected services whether rainy or shinny weather conditions.

Disadvantages of Railway Transport

1. Railway rates are relatively higher than motor transport for transporting light weight articles over short distance.
2. It is inflexible, as it is operated to a particular track which cannot deviate from the set routes.
3. In rural areas, it cannot offer adequate traffic because of uneconomical operating cost.

4. It requires heavy investment for installation of tracks and maintenance that increases its fare on the users.

5. If railways are not fully utilized and if wagons and coaches are to half empty to its capacity, a heavy financial burden will be cast on the railway.

14.03 Recent Trends in Transportation

a) Metro Rail

Metro Rail is a Mass Rapid Transport System (MRTS). It is a convenient, fast, efficient, reliable, comfortable mode of urban transport. Rapid transit also known as heavy rail, metro, subway, tube or underground is a type of high capacity public transport generally found in urban areas.

Metro Rail

Monorail

b) Monorail

A monorail is like a train, but instead of having two sets of wheels that balances on a railway track, the monorail is balanced on top of one rail. Monorails are often used to transport people around large cities. Some monorails utilize magnets to hover on their rails, reducing friction between the train and the rail. The first monorail was invented in the 19th century.

c) Bullet train

High-speed rail is a type of rail transport that operates significantly faster than traditional rail traffic, using an integrated system of specialized rolling stock and dedicated tracks. The first such system began operations in Japan in 1964 and was widely known as the bullet train. High-speed trains normally operate on standard gauge tracks of continuously welded rail.

d) Pipeline Transport

It is the mode of transportation of goods or materials through pipe. Liquids and gases are transported in pipelines. Pipeline exist for the transport of crude and refined petroleum, fuels such as Oil, Natural gas and Bio-fuel etc., and other fluids including sewage, slurry and water. It requires heavy investment to install.

e) Conveyor Transport

It is the broad category of transport mode that includes modes developed from the idea of a conveyor belt. Examples include Conveyor belt, two or more Pulleys with a continuous loop of material that rotates about them, Escalator, Elevator which is used carrying people among floors of building, etc...

f) Ropeway Transport

A Ropeway is another means of transport in naval lifting device. It can be operated in the place where road construction is impractical and costly. Certain limit of goods or people can be transported with the help of (naval lifting device) electricity. In the hilly remote areas ropeway system of transport may be suitable means of transport.

Bullet Rail

Pipeline Transport

g) Hyper loop Transport

Hyper loop is a proposed system of transport that would see pods or containers travel at high level speed through a tube that has been pumped into a near vacuum. The train pods would either float using magnetic levitation technology or float using air caster "Skis", similar to how pucks travel across an air hockey table. With so little friction in the tunnel, the pod would be able to travel at immense speed with projected top speeds of 760 mph. Hyper loop is a futuristic transport system. Tunnels for the Hyper loop would be built either above or below ground, at only around 3 meter in diameter, lacking up a smaller ground footprint than traditional rail or road. Elon Musk an entrepreneur had proposed this mode of transport as a "fifth mode of transport" in 2012.

Ropeway Transport

B. Water Transport

"Water is a free gift of nature'. Human civilization through gradual application of science and technology, have utilized water resources for economic, political and military activities. Remarkable advancements are taking place in water transport due to considerable improvement in the construction, design motive power, speed and safety of ships and boats.

Hyperloop

Water transport is the process of moving people, goods etc. by barge, boat, ship or sailboat over a sea, ocean, lake, canal, river, etc. This category does not include articles on the transport of water for the purpose of consuming the water. Water Transports are of two types

(i) Inland Waterways ii) Ocean Waterways

(i) Inland Waterways

Inland Waterways comprise of rivers, canals and lakes. It is also known as internal water transport. Rivers that are naturally navigable are called natural waterways. Canals and canalized rivers belong to the category of 'Artificial Waterways'. Generally small boats and steamers are operated on rivers to transport people and goods. Where rivers are deep enough, large ships can also ply on them. Canals are man-made waterways, constructed for the twin purposes of navigation and irrigation.

Boat-House

Yatch

Advantages of inland waterways

a) It is considered as the cheapest mode of transport among the other modes of transport.

b) It carries goods smoothly due to the absence of shaking and jolting during transit. It is eminently suitable for the carriage of fragile goods like glassware, earth ware etc., without causing damage.

c) It is most suitable for heavy loads.

d) There is lesser pollution in water transport.

e) Initial investment on river services as well as expenditure on their maintenance is much lesser as compared to road and rail transport.

Disadvantages of inland waterways

a) It is the slowest means of transport. As compared to this, railways are quicker, safer and cheaper means of transport.

b) Floods caused during rainy season, lack of flow of water during summer season affect to ply boats and steamers.

c) Sometimes rivers also change their way. It leads to stoppage and uncertainty in usage of this means of transport.

(ii) Ocean or Sea Transport

Ocean transport has been playing a significant role in development of economic, social and cultural relations among countries of the world. International trade owes its growth to ocean transport. Ocean transport enjoys a pride of place in aiding international trade. Cheapness is its great virtue. In the transportation of low-grade, bulky goods among the countries, the role of ocean transport is commendable.

Types of Ocean Transport

Ocean transport may be divided into two broad categories.

a) Coastal shipping

Coastal shipping constitutes an important means of transport in all countries having a long coastline. It is a cheap means of transport for the movement of bulky cargoes like coal, iron ore etc. to domestic ports of country. Usually, coastal shipping trade of a country is reserved for national shipping. In India, Coastal shipping trade is now exclusively reserved for Indian ships.

b) Overseas shipping

It means the passengers' and goods have to cross ocean. Example India export goods to America.

Ocean going ships may also be divided into two, namely Liners and Tramps:

(i) Liner

An ocean liner is a passenger ship primarily used as a form of transportation across seas or oceans. Liners may also carry cargo or mail, and may sometimes be used for other purposes (e.g., for pleasure cruises or as hospitals ship). They sail to schedule, whether they have a full load or not. They follow defined routes with fixed places and times of call. Regularity of service, god sped and luxurious facilities to passengers are the specialties of liners.

There are two types of liners, namely, Passenger liners and Cargo liners.

(ii) Tramps

Tramps are essentially cargo vessels. See the picture above. They have no set routes. They do not follow any timetable. They sail only when they get sufficient load. They sail at any time and carry cargoes for almost any ports.

DO YOU KNOW?

International shipping Vs Overseas shipping

International shipping can be between countries that are connected by land. For Example, Foreign trade between India and Bangladesh. Overseas shipping means the package has to cross ocean. For Example, International trade between India and South Africa.

The following is the major types of commercial ships

1. General cargo ship 2. Bulk carriers 3. Container ships 4. Auto carrier 5. Tankers 6. Fishing vessels 7. Oil vessels 8. Passengers ships 9. Ferryboats 10. Tow and tug boats 11. Specialized ships

C. Air Transport

Air transport is the fastest and the costliest mode of transport. Commercial air transport is now one of the most prominent modes of overseas transport.The modern air transport has its growth with the invention of Airplane by Wright Brothers.

Air transport is a form of travel in vehicles such as helicopters, hot air balloons, blimps, gliders, hang gliding, parachuting, airplanes, jets or anything else that can sustain flight.

Domestic and International flights

Air travel can be grouped into two general classifications: national/domestic and international flights. Flights from one point to another within the same country are called domestic flights. Flights from a point in one country to a point of different country are known as international flights. Travelers can use domestic or international flights in either private or public travel.

Advantages of Air Transport

a) It provides a regular, convenient, efficient and quick service.

b) Perishable goods like fruits, vegetables, egg, meat, etc., can be transported quickly.

c) It does not require huge investment for construction and maintenance of track like railways.

d) They provide comfortable services for passengers and safety for their goods.

e) It can be used to move goods to areas, which are inaccessible to other means of transport.

f). It is very much helpful for flood or landslide and war rises to the occasion to save human life from danger.

DO YOU KNOW?

"Air Rescuers" was established in the year 1999 for superior patient transfer through Air Ambulance and an elevated standard of care and management through Air Ambulance India. The Air Ambulance services are available in Delhi, Mumbai, Kolkata, Hyderabad and Chennai.

Disadvantages of Air Transport

a) It is a very costly mode of transport. The rates and fares charged by which are beyond the reach of common people.

b) Air craft are not quite suitable for carrying heavy loads and weights.

c) It is not dependable because of unfavourable weather which may disturb the air service suddenly.

d) The construction and maintenance of aerodromes involve a huge capital expenditure.

e) Every country controls the air space above its territory. Therefore, an aeroplane cannot fly over another country without obtaining its prior permission to concern authority.

Services of Transport to Business

The growth and development in the means of transport over the past two hundred years have produced significant economic effects and has revealed how important are the services of transport. It creates place and time utility.

a) It increases the efficiency of production

The object of production is consumption. Effective transport system creates time and place utilities and thereby influences the demand for goods and the value of goods. Thus, transport makes production efficient and purposeful.

b) It stimulates wants by increasing quantity and variety of consumer goods

It helps in getting commodities, which cannot be had or produced in a region due to unsuitable natural conditions. Without adequate and effective transport, goods cannot be had either in the quantities or varieties required in a complex economy.

c) It develops and expands the market

The primary function of transport is to enable the physical distribution of goods at global level. The distribution of goods must take place easily, economically and speedily. It provides the chance of expanding national land international market.

d) It helps in price stability by distributing goods all over the country

e) It aids to economic growth

The movement of raw materials, fuel, labour and finished products and the mobility of capital and technical know-how, transport playing a remarkable role in the growth of all industries from agriculture to manufacturing.

f) It helps in specialization and mass production

Specialization means the division of complex process of production into a number of separate processes so that each person or group specializes in each and every process. It has been extended to international level too.

g) It encourages innovations in product production and designing

It provides plenty of opportunities to the producers to produce their product in innovative and creative way, to catch up the wider market and reap more profit.

14.04 Documents Used in Transportation

a) Way Bill

The way bill is an acknowledgement of receipt of goods for transport by the carrier. The carrier, accepting goods for transport, issues waybills in the name of the consignors or consignees. It serves as an evidence of the contract of transport. It is also a document of tittle of goods. The ownership of goods represented by a waybill can be transferred by endorsement and delivery of the waybill. If a waybill lost, the consignee will be allowed to clear the goods from the carrier after he executes an indemnity bond.

b) Railway Receipt

Railway Receipt is an acknowledgement of receipt of goods by the railway for transporting. It serves as a document of title of goods, viz., it shows the title of its holders of the goods. It may be issued in the name of the consignor or consignee. Only on presentation of the railway receipt the railways will deliver the goods. If railway receipt is lost, the consignees can obtain the goods from the railway by executing an indemnity bond. Ownership of the goods can be transferred by endorsement and delivery of the receipt.

c) Charter Party

When goods are to be consigned in large quantity, it is advantageous to hire the whole or substantial part of the ship. The document through which this contract is made is known as 'Charter Party' may also be known as 'Voyage Charter' or 'Time Charter'. The person who hires the ship is known as 'Charter'. The charter party brings the vessel and crew under the control of the charters. The charter becomes responsible to the third parties for the acts of the master and crew of the ship.

d) Bill of Lading

Bill of Lading is a document containing the terms and conditions of the contract of carriage. It is issued by the shipping company and signed by the captain of the ship. It acknowledges the receipt of the goods described in it on board the ship. It also serves as an official receipt of goods. It is a document of title of goods. The main contents are: Name of Exporter, name of the ship, place of loading, particulars of goods shipped, port of destination, freight paid or to be paid, person to whom delivery of goods is to be made, date etc.

If the condition of the packages is good, a clean bill of lading is issued. If some of the packages are found damaged, a foul or clause bill of lading is issued.

e) Air Consignment Note or Airway Note

It is a document prepared by the consignor, which is handed over to the carrier of goods, while transporting goods through Airways. Air Consignment Note is made out in three original parts. One is signed by the consignor and marked for the carrier. The second is signed by both the consignor and the carrier and marked for the consignee (intended to accompany the goods) and the third is signed by the carrier and handed back to the consignor after the goods have been accepted.

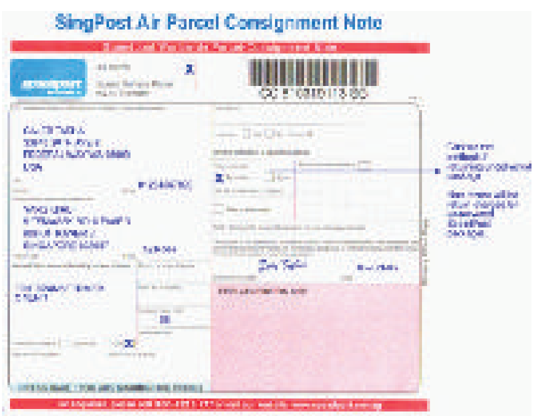
14.05 Common Carrier

A common carrier is a person who is engaged in the business of carrying goods for hire indiscriminately for all persons.

There are organizations transporting goods on designated routes according to a fixed regular schedule, offering to transport goods for hire for all people without discrimination. Railways and Sea transport do not come under common carrier because they are covered by separate Acts. The liability of common carrier is governed by Carriers Act 1865.

For example, city buses are a common carrier. Under common law rules, a common carrier is generally liable for all losses which may occur to property entrusted to his charge in the course of business.

The technological advancement will make the transportation highly sophisticated with greatest speed in future. Transport plays a predominant role in the economic development of a country by helping the business community and public in an enormous way.



SingPost Air Parcel Consignment Note

Air consignment note

SAMPLE

Bill of lading

Key Terms

Consignment Note, Bill of Lading, Liner, Tramps

For Own Thinking

Geographical separation between producer and consumer – Comment.

Importing Crude oil from foreign country to Petroleum refineries – transporting through Truck tankers or Pipelines – Suggest with reason.

Exercise

I. Choose the Correct Answer

1. Transport removes the hindrance of

a. Time
b. Place
c. Person
d. Knowledge

2. Air consignment note is prepared in _____ forms

a. One b. Two.
c. Three d. Four

3. __________ is a document acknowledging the receipt of goods by a carrier

a. Waybill
b. Consignment note
c. Charter party
d. Bill of lading

4. Which is the fastest means of transport?

a. Rail b. Road
c. Sea d. Air

Answers

1. b 2. c 3. a 4. d

II. Very Short Answer Questions

1. Define Transport.
2. State any two services rendered by transport.
3. Write any two advantages of water transport.

III. Short Answer Questions

1. What is bill of lading?
2. What is Charter Party?

IV. Long Answer Questions

1. Explain different types of transport. (any 5)
2. Discuss the advantages of Railway transport. (any 5)

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UNIT III SERVICE BUSINESS - I

CHAPTER 15 INSURANCE

NKE8P

Learning Objectives

To enable the students to
i. learn the concept of Insurance
ii. understand the meaning and principles of Insurance and its types
iii. know various risks in business
iv. legal protection through IRDA

Introduction

"Uncertainty is inherent in human life"

Every business is exposed to different types of risks such as fire, theft, accident etc. Some of the risks can be transferred to specialized institution known as Insurance Companies. Insurance substitute this uncertainty by providing financial compensation. Insurance is nothing but socialization of risks. Insurance companies indemnify the loss of the insured.

15.01 Meaning and Definition of Insurance

Insurance is a contract between the insurer and the insured under which the insurer undertakes to compensate the insured for the loss arising from the risk insured against, in consideration the insured agrees to pay premium regularly. The person whose risk insured is called the insured or assured. The person who agrees to compensate the loss arising from the risk is called the insurer or assurer (or underwriter)

Insurance is a means of providing monetary coverage against loss caused by natural or man-made factors

Definition

"Insurance is a plan by themselves which large number of people associate and transfer to the shoulders of all, risk that attacks to individuals"

- ***According to John Merge***

15.02 Principles of Insurance

Insurance concept was started to distribute risk among group of people. Co-operation is the basic principle behind every Insurance contract. The following are the important principles of Insurance

1. Utmost Good Faith

According to this principle, both insurer and insured should enter into contract in good faith. Insured should provide all the information that impacts the subject matter. Insurer should provide all the details regarding insurance contract. Both the insurer and the insured should display good faith towards each other in regard to the contract.

Example: Mr. M is a heart patient. But he hides this fact to the LIC while taking a life policy. On his death due to a heart attack, LIC can refuse to pay compensation to his legal representative because a material fact was not disclosed by the insured.

2. Insurable Interest

The insured must have an insurable interest in the subject matter of insurance. Insurable interest means some pecuniary interest in the subject matter of the insurance contract. The insured must have an interest in the preservation of the thing or life insured, so that they will suffer financially on the happening of the event against which they are insured.

Example, a businessman has insurable interest in his stock of goods.

3. Indemnity

Indemnity means security or compensation against loss or damages. In insurance, the insured would be compensated with the amount equivalent to the actual loss and not the amount exceeding the loss. This principle ensures that the insured does not make any profit out of the insurance. This principle of indemnity is applicable to property insurance alone.

Example: A businessman gets his sock of goods insured for ₹ 5,00,000. If the goods are destroyed by the fire, the insurance company will be liable to pay compensation for the loss caused to the insured. However, maximum compensation shall be ₹5,00,000 even if loss is more than this.

"The principle of indemnity is not applicable to life insurance because one cannot estimate the loss due to the death of a person"

4. Causa Proxima

The word 'Causa proxima' means 'nearest cause'. According to this principle, when the loss is the result of two or more cause, the proximate cause, i.e. the direct. The direct, the most dominant and most effective cause of loss should be taken into consideration. The insurance company is not liable for the remote cause.

DO YOU KNOW?

Material Fact

A material fact is one which goes to the root of the insurance contract i.e., a fact is material if it can influence the insurer in accepting or declaring the risk or in fixing conditions of insurance or rate of premium.

In the previous example,where 'fire' is accepted as the proximate cause of loss and if there is no fire and goods are destroyed due to excessive heat, the insurance company would not be liable to pay compensation.

5. Contribution

The same subject matter may be insured with more than one insurer then it is known as 'Double Insurance'. In such a case, the insurance claim to be paid to the insured must be shared on contributed by all insurers in proportion to the sum assured by each one of them. It may be noted that in case of multiple insurance, the insured can claim the loss from any of the insurers subject to the condition that the insured cannot recover more than the amount of actual loss from all taken together.

Example: A businessman gets his factory insured against fire for ₹10,00,000 with insurer A and ₹5,00,000 with insurer B. Due to fire, a loss of ₹1,50,000 occurred. Then, insurers A and B will contribute the loss in the ratio of 2:1. A will pay ₹1,00,000 and B will pay ₹ 50,000.

6. Subrogation

Subrogation means 'stepping the shoes on others'. According to this principle, once the claim of the insured has been settled, the ownership right of the subject matter of insurance passes on to the insurer. Otherwise, the insured will realize more than the actual loss which goes against the principle of Indemnity. This is because the insured cannot make any profit by selling the damaged property

Example: Mr. B gets his motor car insured. Some of its parts got damaged at a road accident. He gets the insurance claim and gets the damaged parts replaced with new ones. In this case the damaged parts will be taken by the insurance company. The insured has no right over the damaged parts since they had already got compensation for the damaged parts.

7. Mitigation

In case of a mishap, the insured must take off all possible steps to reduce or mitigate the loss or damage to the subject matter of insurance. This principle ensures that the insured does not become negligent about the safety of the subject matter after taking the insurance policy. Insured is expected to act in a manner as if the subject matter has been insured. If appropriate steps are not taken to save the property then the insured may not get the full compensation from the insurer.

Example: When a factory is insured against fire and theft by insured, insured must take all possible precautions and steps to prevent those from the risk.

15.03 Types of Insurance

Insurance covers different types of risks. All contracts of insurance can be broadly classified as follows:

1. Life Insurance (or) Life Assurance
2. Non-life Insurance (or) General Insurance

It can be further classified into: (i) Fire Insurance; (ii) Marine Insurance; (iii) Health Insurance and (iv) Miscellaneous Insurance.

1. Life Insurance

Life Insurance may be defined as a contract in which the insurance company called insurer undertakes to insure the life of a person called assured in exchange of a sum of money called premium which may be paid in one lump sum or monthly, quarterly, half yearly or yearly and promises to pay a certain sum of money either on the death of the assured or on expiry of certain period.

Importance of Life Insurance

a) Life insurance provides protection to the family at premature death of an individual.

b) It gives adequate amount at an old age when earning capacities are reduced.

c) Life insurance is not only a protection but is a sort of investment because a certain sum is returnable to the assured at the time of death or at the expiry of a certain period.

Types of Life Insurance Policies

Life insurance policies are of many kinds. Some of them are given below:

i) Whole Life Policy

In this kind of policy, the sum insured is payable only on the death of the assured to the beneficiaries or heir of the deceased. The premium is payable for a fixed period (20 or 30 years) or for the whole life of the assured. If the premium is payable for a fixed period, the policy will continue till the death of the assured.

ii) Endowment Life Assurance Policy

Under this type of policy, the insurer undertakes to pay the assured a specified sum, on the attainment of a particular age or on his death, whichever is earlier. In case of death of the assured before he attains the specified age, the sum is payable to his legal heir or the nominee. Otherwise, the sum is paid to the assured, when he attains a particular age. Thus, the endowment policy matures after a limited number of years.

iii) Joint Life Policy (JLP)

The policy is taken up jointly on the lives of two or more persons is known as Joint Life Policy. On the death of any one person, the assured sum or policy money is paid to the other survivor or survivors. The premium is paid jointly or by either of them in installments or lump sum.

Usually this policy is taken up by husband and wife jointly or by two partners in a partnership firm, where the amount is payable to the survivor on the death of either of the two.

iv) Annuity Policy

Under this policy, the assured sum or policy money is payable in monthly or annual instalments after the assured

DO YOU KNOW?

Life Insurance should more properly be called as "Life Assurance" because the risk insured here is certain and natural. Only the tie of occurrence is uncertain.

attains a certain age. In this case, either the whole amount of the premium is paid once or premium is paid in instalments over a certain period. This policy is useful to those who prefer a regular income after a certain age.

v) Children's Endowment Policy

This policy is taken to provide funds for the education or marriage of children. For example, Jeevan Anurag Policy. In this policy, the amount is payable by the insurer when the children attain a particular age. The premium is paid by the person entering into the contract. However, no premium will be paid, if he/she dies before the maturity of the policy.

2. Non – Life Insurance

It refers as the insurance not related to human but related to properties.

(a) Fire Insurance

Fire insurance is a contract whereby the insurer, in consideration of the premium paid, undertakes to make good any loss or damage caused by a fire during a specified period upto the amount specified in the policy.

A claim for loss by fire must satisfy the following two conditions:

(i) There must be actual loss; and

(ii) Fire must be accidental and non-intentional.

Essential elements of Fire Insurance Contract

1. The insured must have insurable interest both at the time of insurance and at the time of loss.
2. The contract is based on the principle of utmost good faith.
3. It is based on the principle of strict indemnity.
4. Fire must be the proximate cause of damage or loss.

(b) Marine Insurance

Marine insurance is a contract of insurance under which the insurer undertakes to indemnify the insured in the manner and to the extent thereby agreed against marine losses. The insured pays the premium in consideration of the insurer's (underwriter's) guarantee to make good the losses arising from marine perils or perils of the sea.

commerce 1-15.indd 143 17-12-2021 8.26.52 PM

Marine perils can be collision of ship with the rock, fire, ship attacked by the enemies, etc. These perils cause damage, destruction or disappearance of the ship and cargo and non-payment of freight. Through marine insurance policy, the insurer undertakes to compensate the owner of a ship or cargo for complete or partial loss at sea.

Essential elements of Marine Insurance Contract

1. It is based on the principle of indemnity
2. The contract is based on utmost good faith.
3. The insurable interest must exist at the time of loss.
4. The principle proximate cause will apply to marine loss only.

Types of Marine Insurance Policies

The three different types of marine insurance policies are:

1. Hull or Ship Insurance:

When a ship is insured against any type of danger, it is known as hull insurance. This policy is taken to indemnify the insured for losses caused by damage to ship.

2. Cargo Insurance:

When a marine insurance policy is taken by the cargo owner to be compensated for loss caused to his cargo during the Voyage, it is known as cargo insurance. The cargo to be transported by ship is subject to many risks, like risk of theft, loss of goods in voyage, etc.

3. Freight Insurance:

When a marine insurance policy is taken to guard against non-recovery of freight, it is known as freight insurance. The shipping company is mainly interested in freight, which it gets either in advance or on the arrival of goods. However, it will not get the freight, if the goods are lost during transit. So, to insure the freight, it takes freight insurance.

A contract of marine insurance covers the ship, cargo and the freight.

(c) Health Insurance

In mid 80's, most of the hospitals in India were government owned and treatment was free of cost. With the advent of Private Medical Care, the need for Health Insurance was felt and various Insurance Companies introduced Health Insurance as a Product. Presently the health insurance exists primarily in the form of 'Mediclaim policy'.

Health insurance policy is a contract between an insurer and an individual or group, in which the insurer agrees to provide specified health insurance at an agreed upon price (premium).Disability resulting from illness or accident may be peril to family because it not only cuts off income but also creates large medical expenses. Health insurance is taken as safeguard against rising medical costs. It provides risk coverage against unforeseen health expenditure that may result in financial hardship.

Types of Health Insurance

There are mainly three types of Health Insurance covers:

1. Individual Mediclaim

It covers the hospitalization expenses for an individual up to the sum assured limit

2. Family Floater Policy

It covers the hospitalization expenses for entire family up to the sum assured limit.

3. Unit Linked Health Plans

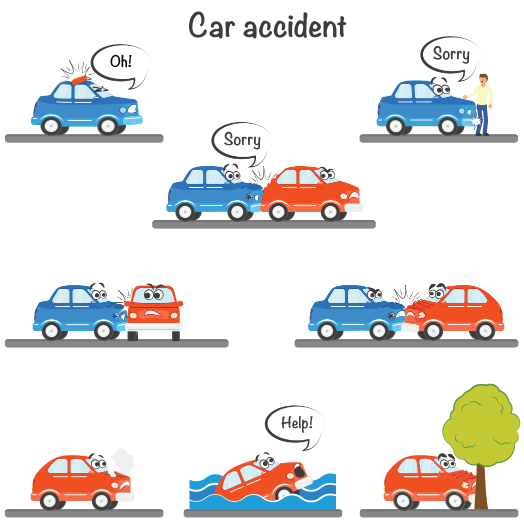
This policy combines health insurance with investment and pays back an amount at the end of the insurance terms.

Health Insurance provides following types of coverage:

Medical expenses – It covers the expenses of hospitalization/nursing home bills and doctors' services.

Disability income – It replaces the income lost while the insured is unable to work.

Claims Settlement



There are two ways by which health insurance claims are settled:

a. **Cashless:** The claim amount needs to be approved by the TPA and the hospital settles the amount with the TPA. (TPA or Third Party Administrator is a middleman between Insurer and the Customer)

b. **Reimbursement:** The insured avails himself or herslef of the treatment and settles the hospital bills directly at the hospital. The insured can claim reimbursement later on by submitting relevant bills/documents for the claimed amount to the TPA

(d) Miscellaneous Insurance

(i) Motor Vehicle Insurance

This is also known as 'Auto Insurance'. This policy comes under General Insurance. This insurance has become very popular and is gaining importance. In motor insurance the owner's liability to compensate people who were killed or injured through an accident is passed on to the insurance company. The premium rate under this policy is standardized.

(ii) Burglary Insurance

This policy comes under the category of insurance of property. Any loss of damage

DO YOU KNOW?

CASCO INSURANCE

The motor casco is a voluntary insurance. It covers the motor vehicle against various risks such as fire, natural disaster, theft of the motor vehicle or the equipment installed therein, a breakdown as a result of collision with another vehicle or object on the road etc.

due to theft, larceny, burglary, house-breaking and acts of such nature are covered by this policy. Compensation of actual loss is done.

i) Insurable interest need not exist at the time of policy but should be present at the time of theft.

ii) The principle of causa proxima is also applied to it. The insurance company would pay only if the proximate cause falls under the policy

(iii) Cattle Insurance

This is a bond in which a sum of money is secured to the insured in case of an event of death of animals like bulls, buffaloes, cows and heifers. The cause of death may be an accident, disease or pregnant condition, etc.

(iv) Crop Insurance

This policy is to provide financial support to farmers in case of a crop failure due to drought or flood. It generally covers all risks of loss or damages relating to production of rice, wheat, millets, oil seeds and pulses etc.

(v) Sports Insurance

This policy is a comprehensive cover for amateur sports persons regarding their sporting equipment, personal effects, legal liability and personal accident risks. If desired it can also be extended to a named member of the insured's family but it is not available to professional sports person. The cover is generally for following sports or more: Angling, badminton, cricket, golf, lawn tennis, squash and use of sporting guns.

(vi) Amartya Sen SikshaYojana

The General Insurance Company offers to secure the education of dependent children under this policy. If the assured parent/legal guardian goes through any bodily injury resulting solely and directly from accident due to external, violent and visible means and if such injury shall within twelve calendar months of its occurrences be the only direct cause of his/her death or permanent total disablement, the insurer shall indemnify the insured student in respect of all covered expenses to be incurred from the date of occurrence of such accident till the expiry of policy or completion of the duration of covered course whichever occurs first and such indemnity shall not exceed the sum assured as stated in the policy schedule.

(vii) Rajeswari Mahila Kalyan Bima Yojana

This policy envisages to provide relief to the family members of insured women in case of their death or disablement due to any kinds of accidents and/or death and / or disablement arising out of other factors incidental to women only.

Terms used in Insurance

I. Nomination

According to Sec 39 of the Insurance Act, 1938, nomination is the process of appointing or nominating a person or persons by the insured, to receive the payment of the policy, in the event of death. The person who is authorized to receive the payment of the policy is called nominee. If the policy matures by expiry of time, the policy amount is payable to the insured himself and not to the nominee.

ii. Surrender Value

The surrender value is the cash value of the policy which is payable to policyholder if he decides to terminate the contract. This surrender value is usually obtained from the paid-up-value by applying a percentage factor. This percentage factor will vary according to the plan of assurance, the original term of the policy and the duration elapsed since the commencement of the policy. The surrender value signifies the amount of premiums paid which is returned to the policyholder at the time of surrendering the policy.

iii. Re-Insurance

It is a contract of insurance, in which an insurer enters into a contract with another insurer to insure the whole or a part of risk covered by the first insurer. It happens when an insurance company feels that it cannot bear the entire risk alone by itself. In such case, it transfers a part of the risk to other insurance companies.

iv. Double Insurance

When more than one insurance policy is taken to cover the same subject matter i.e. risk, then it is known as Double Insurance.

BUSINESS RISKS

Insurance covers various risks of traders and others. Therefore the concept of risk need to be studied. The term 'business risk' refers to the possibility of inadequate profits or even losses due to uncertainties or unexpected events. Risk is different from uncertainties.

Nature of Business Risks

Business risks can be understood in terms of their peculiar characteristics:

(i) Business Risks Arise Due to Uncertainties

Uncertainty refers to the lack of knowledge about what is going to happen in the future. Natural calamities, change in demand and prices, changes in government policy, improvement in technology, are some of the examples of uncertainty which create risks for business because the outcome of these future events is not known in advance.

(ii) Risk is an Essential Part of Every Business

Every business has some risk. No business can avoid risk, although the amount of risk may vary from business to business. Risk can be minimized, but cannot be eliminated.

(iii) Degree of Risk Depends Mainly Upon the Nature and Size of Business

Nature of business (i.e. type of goods and services produced and sold) and size of business (i.e., volume of production and sale) are the main factors which determine the amount of risk in a business. For example, a business dealing in fashionable items has a high degree of risk. Similarly, a large-scale business generally has a higher risk than what a small scale business has.

(iv) Profit is the Reward for Risk Taking:

'No risk, no gain' is an age-old principle which applies to all types of business. Greater the risk involved in a business, higher is the chance of profit. An entrepreneur undertakes risks under the expectation of higher profit. Profit is thus the reward for risk taking.

Types of Business Risks

The business risks may be classified as

i) Speculative Risks

Speculative risks are the kind of risks which have the possibility of gain as well as the possibility of loss. Such risks are the result of market conditions. Favourable market conditions result in gains whereas unfavourable market conditions result in losses.

Example: Use of better technology helps to produce better quality products at cheaper prices. This may increase the demand and thus result in higher profits.

ii) Pure Risks

Pure risks are the type of risks where business suffers loss only if the risk occurs. Non-occurrence of such risks leads to absence of loss.

Example: Business may suffer loss only if fire, theft or strike occurs.

iii) Insurable Risks

Insurable risks are the type of risks where business can insure the probable losses by paying a predetermined premium to an insurance company. At the time of loss the insurance company pays compensation on the basis of agreed terms and conditions. Loss arising from natural and physical risks can be insured as the probability of risk can be determined.

Example: Company can insure its stock against fire or theft and if it loses its stock due to fire or theft in office, the insurance company pays compensation only upto a extent of the value lost.

iv) Uninsurable Risk

Losses arising from unforeseen natural events, political changes or trade cycles are called uninsurable risks. Loss due to earthquake or flood or cyclone cannot be estimated and their probability cannot be calculated. Government directly takes care of the affected persons. Losses to businesses due to policy decisions of ruling political parties in a country, or due to economic depression cannot be insured. These uninsurable risk events are called uncertainties. The concept of risk is different from uncertainty. During uncertain events decisions cannot be taken.

Causes of Business Risks

Business risks arise due to a variety of causes, which are classified as follows:

(i) Natural Causes

Human beings have little control over natural calamities like flood, earthquake, lightning, heavy rains, famine, etc. These result in heavy loss of life, property, and income in business.

(ii) Human Causes

Human causes include such unexpected events like dishonesty, carelessness or negligence of employees, stoppage of work due to power failure, strikes, riots, management inefficiency, etc.

(iii) Economic Causes

These include uncertainties relating to demand for goods, competition, price, collection of dues from customers, change of technology or method of production, etc. Financial problems like rise in interest rate for borrowing, levy of higher taxes, etc., also come under this type of causes as they result in higher unexpected cost of operation of business.

(iv) Other Causes

These are unforeseen events like political disturbances, mechanical failures such as the bursting of boiler, fluctuations in exchange rates, etc. which lead to the possibility of business risks.

15.04 Insurance Regulatory Development Authority of India (IRDAI)

IRDAI – Insurance Regulatory Development and Authority of India is the statutory, independent and apex body that governs, regulates and supervises the Insurance Industry in India. It was constituted in the year 2000 by Parliament of India Act called IRDAI Act, 1999. Presently IRDAI headquarters is in Hyderabad.

Organisational Setup of IRDAI

IRDAI is a ten member body consists of

i. One Chairman (For 5 years & Maximum age – 60 years)

DO YOU KNOW?

1. Employee Group Insurance in India.

2. Passengers (All transport) Insurance Scheme.

For future Learning

David beckham, the famous football player from the UK first insured his legs for about 100 million pounds. as he became one of the most populous soccer players in the world, he insured his whole body for $195 million to cover the risks of injury, illness, and disfigurement. This policy would cover him financially if he were to lose any of the endorsements that depended on his looks. $195 is approximately equal to $12,337.65 million.

ii. Five whole-time Members (Not 5 years and Maximum Age – 62)

iii. Four part-time Members (Not more than 5 years)

iv. The chairman and members of IRDA are appointed by ;the Government of India

Objectives of IRDAI

1. To promote the interest and rights of policy holders.

2. To promote and ensure the growth of Insurance Industry.

3. To ensure speedy settlement of genuine claims and to prevent frauds and malpractices

4. To bring transparency and orderly conduct in financial markets dealing with insurance.

Section 14 of IRDAI Act, 1999 lays down the duties and functions of IRDAI:

i. It issues the registration certificates to Insurance Companies and regulates them.

ii. It provides license to insurance to intermediaries such as agents and brokers after specifying the required qualifications and set norms/code of conduct for them.

iii. It promotes and regulates the professional organizations related with insurance business to promote efficiency in insurance sector

iv. It regulates and supervises the premium rates and terms of insurance covers.

v. It specifies the conditions and manners, according to which the insurance companies and other intermediaries have to make their financial reports.

vi. It regulates the investment of policyholder's funds by insurance companies.

vii. It also ensures the maintenance of solvency margin (company's ability to pay out claims) by insurance companies.

Key Terms

utmost good faith, Indemnity, Causa Proxima, Subrogation, Mitigation, Surrender value

Student Activity

a) Sanjana insured her factory for ₹5 Lakh against fire. Due to fire she suffered a loss of ₹2 lakh. How much amount she can recover from the insurance company? Why?

b) A factory owner gets his stock of goods insured, but he hides the fact the electricity board has issued him a statutory warning letter to get his factory's wiring changed. Later on, the factory catches fire due to short circuit of wiring. Can he claim compensation?

Exercise

I. Choose the Correct Answer

1. **The basic principle of insurance is ________**

   a) Insurable Interest
   b) Co-Operation
   c) Subrogation
   d) Proximate causa

2. **______ is not a type of general insurance**

   a) Marine Insurance
   b) Life Insurance
   c) Fidelity Insurance
   d) Fire Insurance

3. **Which of the following is not a function of insurance?**

   a)Lending Funds
   b) Risk sharing
   c) Capital formation
   d) Protection of life

4. **Which of the following in not applicable in insurance contract?**

   a) Unilateral contract
   b) Conditional contract
   c) Indemnity contract
   d) Inter-personal contract

5. **Which one of the following is a type of marine insurance?**

   a) Money Back Policy
   b) Cargo Insurance
   c) Hull Insurance
   d) both b & c

Answers

1. a 2. b 3. d 4. c 5. d

II. Very Short Answer Questions

1. List any five important types of policies.
2. What is health insurance?

III. Short Answer Questions

1. Define Insurance.
2. Give the meaning of Crop insurance.
3. Write a note on IRDAI.

IV. Long Answer Questions

1. Explain the various types of Insurance. (any 5)
2. Explain the principles of Insurance. (any 5)

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UNIT IV SERVICE BUSINESS - II

CHAPTER 16 EMERGING SERVICE BUSINESS IN INDIA

Learning Objectives

To enable the students to

i. gain knowledge on franchising business
ii. learn about factoring and its importance
iii. study the fundamentals of logistics
iv. be aware of the outsourcing business

16.01 FRANCHISING

A. Meaning and definition

One of the key components of success of any business lies in its ability to reach out to customers at local, national and global level. Franchising has often been used as a method for expanding domestic market and for entering international markets. A wide variety of goods and services are now made available to customers using this model. Franchising is used by businesses for marketing and distributing products and services.

According to International Franchise Association a franchise is a "*continuing relationship in which the franchisor provides a licensed privilege to do business, plus assistance in organising training, merchandising and management , in return for a consideration from the franchisee.*"

As explained in Wikipedia, franchising is "*the practice of the right to use a firm's business model and brand for a prescribed period of time. ... For the franchisor, the franchise is an alternative to building "chain stores" to distribute goods that avoids the investments and liability of a chain*".

There are two parties to a franchising agreement

Franchisor: The owner of a business who provides the franchise. Generally he owns the patent / trademark and offers it to the franchisee under a licensing agreement. Depending on the agreement, the franchisor may also provide support services like service/product training, marketing, advertising, etc. The franchisor levies fees in the form of royalty.

Franchisee: The individual who acquires the right to operate the business or use the trademark of the seller is known as the franchisee.

B. Characteristics of franchising

(i) Franchise relationship is based on an agreement which lays down terms and conditions of this relationship.

(ii) The term of franchise may be for 5 years or more. The franchise agreement may be renewed with the mutual consent of the parties.

(iii) The franchisee gives an undertaking not to carry any other competing business during the term of the franchise; and the franchiser gives an undertaking not to terminate the franchise agreement before its expiry except under situations which may justify the termination of the franchise agreement.

(iv) The franchisee agrees to pay specified royalty to the franchiser, as per terms of the franchise agreement.

(v) Franchise means selling the same product and maintaining a similar type of shop decor (i.e. style of interior decoration) for which franchiser provides assistance to franchisee in organising, merchandising and management. The franchiser virtually sets up the business for the franchisee.

(vi) Franchisee is supposed to follow parent company's policies regarding mode of business operations, as per clauses in the franchise agreement.

(vii) Franchiser may give training to personnel working in the franchisee's organization.

C. Types of franchising

There are primarily two types of franchising

a) Product/ trade name franchising: In this type, the franchisee exclusively deals with a manufacture's product. Examples include Kidzee, French Loaf outlets, Bharat Petroleum bunks,Patanjali products, etc. Relationships like Maruti Suzuki with ABT Maruti or Hero Honda bike dealerships may be considered as franchises. However, they but should be considered more as exclusive dealerships with more operational freedom for the dealers.

b) Business format franchising: When a franchisor awards rights covering all business aspects as a complete business package to the franchisee it is called as business format franchising. This package includes training , support and the corporate name. This enables uniformity of products, services, environment across geographical boundaries with a high degree of standardisation. Examples are McDonald's, Pizza Hut. KFC, Hot breads, Titan, Color plus, Zodiac, Lakmé beauty parlour.

D. Advantages of franchising

a) ***Reduced risk:*** The franchisee will acquire the right of running an already established business, thus eliminating the risk of starting a new business.

b) ***Business expansion:*** Franchising provides an opportunity to expand business at regional, national and global levels without incurring additional expenditure. Thus rapid growth of franchisor's business is facilitated.

c) ***Cost of advertising:*** The cost of advertising for the franchisor will be reduced since this cost will be shared by the franchisee. Moreover, it enables the franchisor to reap the benefits of increased visibility across regional and national boundaries.

d) ***Operational support:*** The franchisee is provided assistance in not only obtaining finance,but also in deciding business location , decor /design, staff training, and handling day to day operations.

Top 10 Franchises in India 2017				
Position	Name of Franchise	Country of Origin	Number of Years of Franchising in India	Industry
1	Subway	USA	16	Food & Beverage
2	Aloha India	Malaysia	15	Education & Training
3	Baskin-Robbins	USA	24	Food & Beverage
4	Kidzee	India	14	Children's
5	US Dollar Store	India	13	Retail
6	McDonald's	USA	21	Food & Beverage
7	Khadim's	India	22	Retail
8	Prestige Smart Kitchen	India	14	Retail
9	Domino's Pizza	USA	21	Food & Beverage
10	Bachpan (A Play School)	India	13	Children's

Examples of Indian Franchise

KIDZEE

WHERE KIDS LOVE TO LEARN

http://www.kidzee.com/partner-with-us/

Kidzee school franchise

Committed to quality education

Minimum area of 2000-3000 sq. ft.

Minimum investment ₹ 12, 00,000

Franchise with Oriental Cuisines Private Limited

Haldiram takes Franchise route to add 150 stores

Particulars	The French Loaf	Wangs Kitchen
Floor placement	Ground floor properties with good frontage	
Carpet Area	350 - 500 sq.ft.in a high footfall area.	800 - 1000 sq.ft. in a high footfall area
Investment	₹20 - 25 Lakh Approximately	₹50 - 65 Lakh Approximately
Location	Chennai, Rest of Tamil Nadu, Bengaluru, Mangalore, Mysore, Hyderabad & Kolkata	

E. Disadvantages of franchising

a) ***Franchising fees:*** The initial franchising fee and the subsequent renewal fees can be very high in case of successful businesses. From the franchisee's point of view, this may be a deterrent.

b) ***Fixed royalty payment:*** The franchisee has to make payment of royalty to the franchiser on a regular basis. This considerably reduces the income of the franchisee.

c) ***Danger of image tarnishing:*** If the franchisee does not maintain standards of quality and service; there is a danger that the goodwill and image of the reputed franchiser will be adversely affected.

d) ***Lack of freedom:*** The franchisee does not have the freedom to run his business in an independent manner. He has to abide by management and operational policies of the franchiser, This may serve as a deterrent whether suitable to him or not.

e) ***Limitation on range of products:*** The franchisee cannot introduce new product lines into the business, except those permitted by franchiser. This may mean loss of business to franchisee amidst demands based on local conditions.

F. Conclusion

Franchising enables a franchisor to expand the existing business to wider geographical regions within the country and abroad. Franchisees, especially those who are new entrants to business, do not have to "start from the scratch", but work with an established business model getting the necessary operational support and guidance. In international business, franchising is the best option to enter other country markets.

16.02 FACTORING

A. Introduction

Firms sell goods on cash and credit basis. When goods are sold on credit basis, bills are drawn on the buyer by the seller. In case of small and medium business, a considerable part of their working capital is tied down in bills receivables. The liquidity position of the firm is affected and this hinders the smooth functioning of the business. In order to overcome this hurdle, Factoring as a service has emerged.

B. Meaning and Definition

Factoring is derived from a Latin term "*facere*" which means 'to make or do'. Factoring is an arrangement wherein the trade debts of a company are sold to a financial institution at a discount. The factor is an agent who buys the accounts receivables (Debtors and Bills Receivables) of a firm and provides finance to a firm to meet its working capital requirements.The main advantage of factoring is that the small or big business firm receives short term finance (working capital) to meet day-to-day payments.

In a report submitted to the Reserve Bank of India, Mr.C.S.Kalyanasundaram defines factoring as "*a continuing arrangement under which a financing institution assumes the credit and collection functions for its clients, purchases receivables as they arise (with or without recourse for credit losses, i.e., the customer's financial inability to pay), maintains the sales ledgers, attends to other book-keeping duties relating to such accounts, and performs other auxiliary duties*".

The Factoring Regulation Act 2011 governs the registration of factors and regulating the assignment of receivables and the associated obligations.

C. Factoring Process

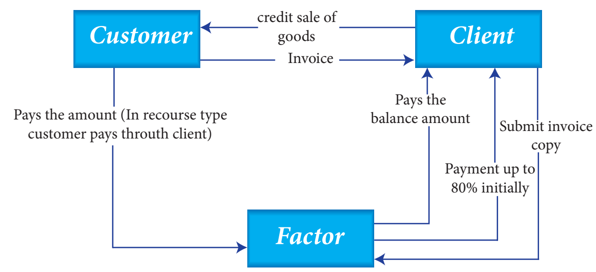
a) The firm enters into a factoring arrangement with a factor, which is generally a financial institution, for invoice purchasing

b) Whenever goods are sold on credit basis, an invoice is raised and a copy of the same is sent to the factor.

c) The debt amount due to the firm is transferred to the factor through assignment and the same is intimated to the customer.

d) On the due date, the amount is collected by the factor from the customer.

e) After retaining the service fees, the remaining amount is sent to the firm by the factor



D. Features of Factoring

a) Maintenance of book-debts

A factor takes the responsibility of maintaining the accounts of debtors of a business institution.

b) Credit coverage

The factor accepts the risk burden of loss of bad debts leaving the seller to concentrate on his core business.

c) Cash advances

Around eighty percent of the total amount of accounts receivables is paid as advance cash to the client.

d) Collection service

Issuing reminders, receiving part payments, collection of cheques form part of the factoring service.

e) Advice to clients

From the past history of debtors, the factor is able to provide advices regarding the credit worthiness of customers, perception of customers about the products of the client, etc.

E. Types of factoring

a) Full service factoring or Without recourse factoring:

When a factor agrees to provide complete set of services which includes financing, maintenance of sales ledger, debt collection at his own risk, and providing consultancy services as and when necessary, it is called as full servicing factoring.

b) With recourse factoring

When the factor does not undertake credit risk, it is known as with recourse factoring. In case the debtor fails to make the payment on due date, it is assigned back to the firm by the factor. Here the responsibility of collecting the amount lies with the selling firm.

c) Maturity factoring

In this type, the factor agrees to finance the firm only after collecting the amount on maturity from debtors.

d) International factoring

When the claims of an exporter are assigned to a financial institution and the finance is advanced on the basis of export invoice it is called as international factoring.

The factoring process involving the client firm, factor and the customer is given below.

F. Factoring vs Forfaiting

Forfaiting is defined as "the non-recourse purchase by a bank or any other financial institution of receivables arising from an export of goods and services".

Examples of Factoring companies in India

Canbank Factors Limited:

http://www.canbankfactors.com

SBI Global: http://www.sbiglobal.in

IFCI Factors Limited: http://www.ifcifactors.com

Export Credit Guarantee Corporation of India Ltd: https://www.ecgc.in/Portal/productnservices/maturity/mfactoring.asp

Small Industries Development Bank of India (SIDBI):http://www.sidbi.com/?q=receivable-finance-scheme

G. Conclusion

Factoring helps smooth running of business by getting short term credits from financial institutions against accounts receivables. Forfaiting is a variation of factoring with focus on international exports.

S. No.	Characteristics	Factoring	Forfaiting
1.	Basis of financing	Financing is dependent on exporter's credit standing	Financing is dependent on the availing bank's financial standing
2.	Cost	Cost is borne by the seller	Cost is borne by the overseas buyer
3.	Suitability	For transactions of short-term maturity period	For transactions of medium-term maturity period
4.	Extent of financing	Only a certain per cent of receivables factored is advanced	Full finance is available
5.	Risk	Risk can be transferred to seller	All risks are borne by the forfeiter

16.03 LOGISTICS

A. Meaning

Logistics can be viewed as a logical extension of transportation and related areas to achieve an efficient and effective goods distribution system.

B. Logistics Management

Logistics Management is defined as 'Design and operation of the physical, managerial, and informational systems needed to allow goods to overcome time and space (from the producer to the consumer)'. This implies that an integrated view of a number of different activities and functions may be required. These activities are represented as part of the value chain, called the generic value chain by Porter. All firms are viewed as a collection of primary and secondary activities.

C. Decisions

The logistics management involves various decisions that need examination for an integrated system, they are:

Product design, Plant location, Choice of markets/sources, Production structure, Distribution/Dealer network design, Location of Warehouses, Plant Layout and Logistics, Allocation Design, Production Planning, Inventory Management – Stocking Levels, Transportation-mode Choice, Shipment Size and Routing Decisions, and Transport Contracting, Packaging, Materials Handling, Warehousing Operations.

D. Key Actors

Shippers (users of logistics), Suppliers (of logistics services) – Carriers (rail, road, air, water, pipeline, rope-way), Warehouse Providers, Freight Forwarders, Terminal Operators (ports, stevedores etc), Government (regulator of logistics).

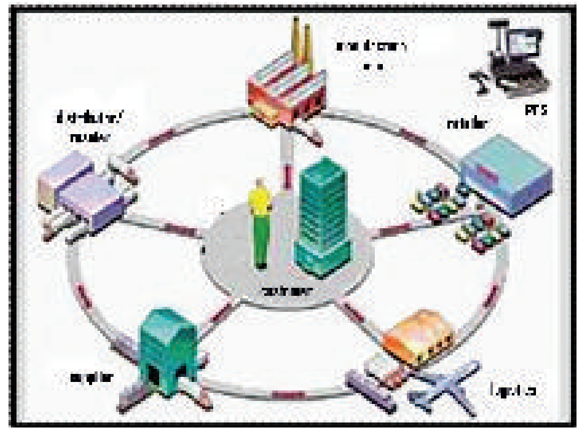
Organisations taking proactive managerial attention in co ordinating the actors in logistics leads to reduced logistics costs and improved customer service.

E . Role of Government

The government plays a significant role in logistics in India. The important legislations that affect logistics are Central Sales Tax and Local Sales Tax, Consignment Tax, Excise Duties, Octroi and Entry Tax, Use of Packaging Material, MODVAT, GST, Motor Vehicles Act and similar acts for other modes, Distribution of Policies.

F. Classification of Logistics Applications

The Logistics Management can be classified on the basis of applications from various dimensions in the process of examining and evaluating alternatives. They are 1. Decision-wise 2. Actor-wise 3.Inbound logistics and Outbound logistics



G. Elements of Logistics Cost

The important elements of logistics cost are

Product Inventory at source, Pipeline Inventory, Product Inventory at Warehouses and Dealers, Transit Losses/Insurance, Storage Losses/Insurance, Handling and Warehouse Operations, Packaging, Transportation, Customers' Shopping.

H. Models in Logistics Management

The decision areas of Logistics can be addressed using various quantitative models from Operations Research namely

i. Forecasting Models ii. Mathematical Programming Models – Location Models, Allocation Models, Distribution Network Design Models iii. Inventory Models iv. Routing Models v. Scheduling Models vi. Alternatives Analysis

I. Logistics and Infrastructure

Generally a good transportation, storage, handling and information infrastructure helps in efficient logistics management. In India most of the transportation happens through road and rail. Pipeline and Water transport are to be fully utilized further. Air transportation is used for high value commodities. In transportation infrastructure the following framework can be used to identify the problem areas like Right of way, Vehicle, Motive power, Terminals, Operations/systems.

J. Logistics Management to Supply Chain Management

Logistics Management deals with the efficient management of a static gap between demand and supply whereas Supply Chain Management tries to identify the dynamic nature of the value creation itself such as responsiveness, quality and design. Hence, it aims for an effective management response over the longer run.SCM focuses on profit maximization rather than cost minimization. LM activity is supply driven and SCM is more demand driven.

MTQWH

16.04 OUTSOURCING

A. Meaning of Outsourcing

Recently a new type of business in service sector has become popular in the world. It is called the Business Process Outsourcing (BPO). BPO refers to outsourcing the work which is routine in nature, to an outside agency. This practice was initiated in United States of America in few companies. The routine work of a company if outsources the company concentrate on critical issues without wasting time on routing job. In later years it became popular in other countries also. For example designing an advertisement, after sales service, maintance of accounts etc. can be outsourced.

The companies must identify their core competence and concentrate on that function and outsource all other routine function to outside agencies, who are specialized in those functions.

B. Features of Outsourcing

1. Transferring Non Core Activities to Outsiders

Companies can outsource those non core activities functions like maintenance, housekeeping, gardening, etc. to outsiders, depending upon the nature of the business and the activities are identified as core or non core activities.

2. Outsourcing Involves Contracting

As the companies start outsourcing their activities focusing on their main business, the outside agencies enter into an agreement with the company to perform the routine activities on a contractual basis.

3. Operational Efficiency through Outsourcing

Companies specialize in their business system as the time available at their disposal can be utilized for the core activities leading to efficiency improving quality of the product.

4. Improved Customers Satisfaction

The number of customers can be increased through timely delivery and high quality services. Outsourcing helps in customer satisfaction and results in repetitive purchase of the same product

5. Cost Reduction

The only way to survive and earn profit is through global competitiveness by fixing a competitive price. Division of labour and specialization along with good quality product reduces the cost. For example outsourcing of research and development, manufacturing, software development etc.

C. Core and Non Core activities

Companies can benefit in the long run provided they are keen on their core activities rather than non core activities. A core activity involves experience, expertise, efficiency and even investment in the field of specialization. Non core activities can be outsourced to outsiders who are specialists in their area of operation.

D. Benefits

1. Focusing on Core Activities

Companies can focus on their core competence, a few areas where the company has distinct capability. The rest of the activities (non core) can be outsource to outside agencies.

2. To Fill up Economic Development

Outsourcing stimulates entrepreneurship, encourages employment opportunities, expands exports, enables tremendous growth of the economy.

3. Encourages Employment Opportunities

Companies that are outsourcing their non core activities provide chances for other small business units to take up the activities. This paves way for more job opportunities and new employment avenues.

4. Reduction in Investment

Companies through outsourcing avails the services of outsiders which in turn reduces the investment requirements. The amount so available can be utilized productively and this increases the profits.

5. Quest for Excellence

Outsourcing enables the firms to pursue excellence in two ways namely excelling themselves in the activities they do and excel outsiders by extending their capabilities through contracting out.

E. Business Process Outsourcing (BPO) and Knowledge Process Outsourcing (KPO)

Meaning

BPO means getting contractual services of external companies or group of companies to complete special work or process of a company. For example call centres, data entry etc. This reduces the expenditure by using cheap labour available in developing countries like Indian, China etc.

Need for BPO

1. To focus on key function
2. benefit of specialization / efficiency
3. cost cutting
4. Economic growth and development
5. Increasing profit
6. Catering to the dynamic demand

Knowledge Process Outsourcing (KPO)

Meaning

KPO refer to outsourcing of Knowledge based Process. It means obtaining high end knowledge work from outside the organization in order to run the business successfully and in cost effective manner. In short KPO firms get knowledge related, information related, work done from outside firm and it involves high value work carried highly skilled staff.

Need for KPO

1. Usage of best skills
2. Ultimate use of knowledge
3. Finding solution to complex problem

4. Reduction of expenditure
5. Special focus on principal functions
6. Outsources reduces risk

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16.05 E-COMMERCE

E - Commerce or Electronic Commerce is the buying and selling of goods and services through electronic networks like internet. E – Business is a broader term which includes internal and external transaction of an organization across the internet. The internal transactions include finance, production, operations etc., while external transactions include customer – service, sales, marketing and business to business transactions. The term e – commerce denotes mainly external transactions, According to Deloitte Association report, seventy percent of revenue in e – Commerce in India in the year 2015 was only from online travel followed by online retail which accounted for 20 percent of revenue. The major segments in the sphere of e – commerce includes Health, Education, Real estate, Financial services, Digital downloads, Online classified advertisement etc.,

B. General Impact of E – commerce

About 40 million people of India is said to be employed in E – Commerce sector either directly or indirectly

i) E – commerce generates great opportunities for entrepreneurship in the sphere of online retailing, online service digital commerce and so on

ii) E – commerce companies have invested heavily in supply chain area, warehousing, and delivery points

iii) With a rise in e - commerce transactions sale of financial, physical and data security system related products has seen tremendous growth in India

iv) E – commerce promotes innovative practices of carrying on business. Social media and social media networks have opened new ways of transacting with the customers through e - commerce

v) Thanks to wider broad band connectivity many business concerns are switching over to e – commerce mode of transacting business

vi) More contemporary customers are buying through Flipkart and Amazon

vii) Direct marketing companies are using internet to promote products and render efficient customer service

C. Impact of E- commerce on vendors

i) Vendors could have a wider access to customers across the globe

ii) This helps minimize the cost of operating business due to direct distribution of goods to end consumers thanks to minimum invention of intermediaries

iii) Vender could interact with multiple buyers and sellers

iv) Business concerns could orient marketing efforts towards targeted customers.

D. Impact of E-commerce on buyers

i) Buyers could have a global access to information about variety of products and services available in the market

ii) They could buy the products/services round the clock from anywhere in world

iii) The prices of products bought through e – commerce tend to be relatively lower than those purchased physically in the conventional shops due to offers, discount etc.

iv) Electronic and software products could be downloaded immediately after purchase through e – commerce mode

v) Customers could participate in e auction which is one of the facets of e – commerce and get contract in a free and fair manner

vi) Individuals could sell their used products through e – commerce mode with relative ease.

vii) Buyers can bargain and negotiate better terms and conditions with respect to buying knowledge products.

E. E – Commerce Domains/Models

1. Business to Customers (B 2 C)

This is fastest growing segment in e – commerce spare. Under this model, business concern sells directly to consumers

2. Business to Business (B 2 B)

Under the model, business concerns transact with one another through internet. For instance, Snapdeal, Filipkart, Alibaba, Indamart, Trade India. Com etc.

3. Consumer to Consumer (C 2 C)

Under this model, customers sell directly to other customers through online classified advertisement or through auction or through mobile or through market places. Example. Indian ventures in C 2 C are Kraftly App (buying and selling anythings) which deals in hand made products of a wide range. Onceagainstore. Com is a website that buys pre – owned women's fashion products. Other players are quirkr,Olx, ebay etc..

4. Customer to Business (C 2 B)

This model is reverse to auction model. Products like automobile, electronic items furniture and smilar product are traded by customer through websites. Example Naukri.com, and Monster.com are examples of Indian companies operating in this domain

5. Business to Government (B 2 G)

This model envisages selling products and services by business consumer to Government organization . For instance TCS operates the passport application process for the Government of India as part off - line process

Key Terms

Franchiser	Franchisee
Merchandising	Standardisation
Liquidity	Factor
Customers	Recourse
Transportation	Design
Operation	activities
application	framework

Key Terms (continue)

Specialisation	competence,
core activity	call centre,
Business Process Outsourcing,	
Knowledge Process Outsourcing,	
online business,	
economic development	
Electronic	Digital
Internet	Business
Logistics	Factoring
Outsourcing	

Self Study Exercise

Identify and write about five examples of franchises in your area.

[Hint: couriers, eating houses, training centres]

For Own Thinking

You are a small scale manufacturer of ignition coils for automobiles, located near Ranipet. Explain how will you avail of financial credits through factoring if you get orders from

a. Ford India , Chennai

b. Maruti Suzuki, Gurgaon

c. Kun Hyundai, Seoul

To identify the core activities of any business

To analyse the benefits of Outsourcing noncore items

To evaluate the areas which needs KPO

To understand critically analyse the impact of call centers

For Future Learning

1. Identify methods of moving goods
2. Draft ways and means of overcoming the problems in Logistics
3. Project the future of Logistics Management in India

1. Suggest methods of discriminating core and non core items
2. Write ways and means of overcoming the drawbacks of BPO,KPO
3. Project the future of outsourcing on economic development

To identify the activities involved in the movement of goods

To analyse the benefits of Logistics

To evaluate the areas which need more focus relating to Logistics

To understand critically and analyse the impact of Logistics on Profitability

Exercise

QF5P6

I. Choose the Correct Answer

1. **A continuing relationship which provides a licence privileges to do business and provides training, merchandising for a consideration is called ____________**

   a) Franchising

   b) Factoring

   c) Supply Chain Management

   d) Exchange

2. **Buying and selling of goods through electronic network is known as _____**

   a) E-commerce

   b) internet

   c) Website

   d) Trade

3. **An organization carrying out activities to move goods from producer to consumer is**

   (a) Transport

   (b) Logistics

   (c) Channels

   (d) Marketing

4. **The main benefit of Logistics is**

   (a)Productivity

   (b) Cost Minimisation

   (c)Profitability

   (d) Storage

5. **The main benefit of outsourcing is**

   (a) Productivity

   (b) Cost reduction

   (c) Skill

   (d) Units

Answers

1. a 2. c 3. a

4. b 5. b

II. Very Short Answer Questions

1. Who is a Franchisee?
2. State two disadvantages of Franchising.
3. What is meant by BPO?
4. What is meant by Logistics?

III. Short Answer Questions

1. What are the types of Franchising?
2. List the steps in factoring process. (any 3)
3. What is the impact of e-commerce on buyers? (any 3)

IV. Long Answer Questions

1. Enumerate the advantages of Franchising. (any 5)
2. Elucidate the features of factoring.

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ICT CORNER

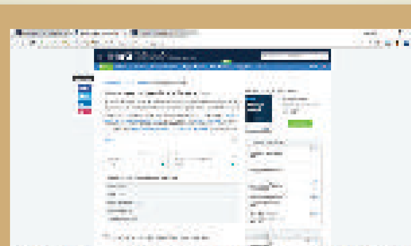
E-COMMERCE-STATISTICS

Explore retail e-commerce sales growth worldwide

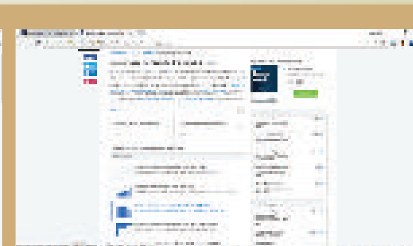
STEPS:

- Open the Browser and type the URL given (or) Scan the QR Code.
- “STATISTICA-The Portal for Statistics” page will open. Click on “E-Commerce” menu in the page.
- “E-commerce worldwide - Statistics & Facts” page will open. Under the heading “E-Commerce Worldwide - important statistics” there are 5 Menus (1) Overview (2) Digital shoppers (3) Shopping behaviour (4) Mobile retail (5) Digital payment
- Under “Overview” select “Retail e-commerce sales growth worldwide 2014-2021”. Access to “Overview “ is FREE
- Graphical representation for “Annual retail e-commerce sales growth worldwide from 2014 to 2021” will appear. If you move the cursor over the bars respective data will appear. Analyse the data’s. Open other data’s in overview and analyse.
- If you want to download the graph and data as pdf file you can click on the menu on the right top. Register when you are asked to register for certain free access.

Step1



Step2



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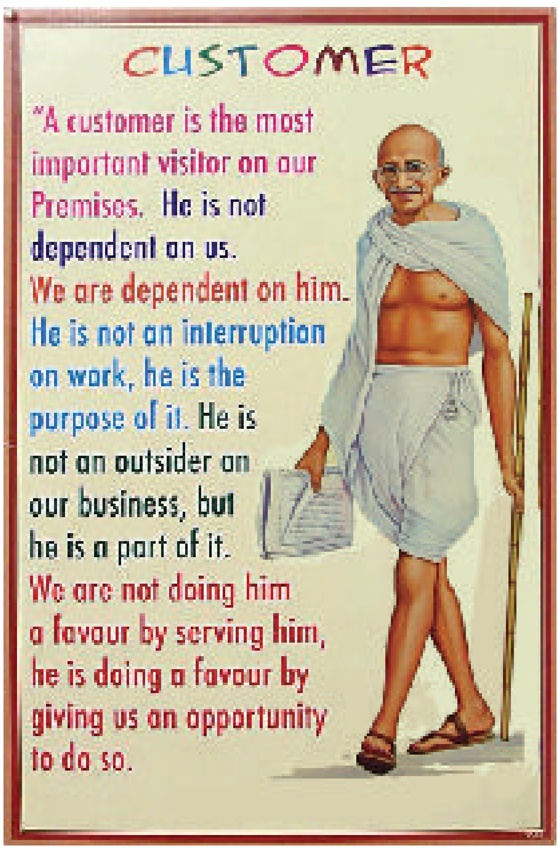
UNIT V SERVICE BUSINESS - III

CHAPTER 17 SOCIAL RESPONSIBILITY OF BUSINESS



Learning Objectives

To enable the students to

i. have better understanding of the concept of Social Responsibility
ii. identify the need for studying Social Responsibility
iii. comprehend on different view points for and against Social Responsibility
iv. specify various kinds of Social Responsibilities

Introduction

A business entity carries out economic activities on a regular basis to earn profits. These entities spend money on different aspects of business which do not give them profit directly. For example, businessmen take the responsibility of maintaining and developing gardens and parks on streets and squares in cities. Some businessmen engage themselves in research for improving the quality of products; some provide housing, transport, education and health care to their employees and their families. In some places businessmen provide free medical facility to poor patients. Sometimes they also sponsor games and sports at national as well as international level.

***P**urpose of **S**ocial **R**esponsibility of **B**usiness*

17.01 Concept of Social Responsibility

The term social responsibility is defined in various ways. Every businessman earns prosperity from business and should give back the benefit of this prosperity to society. This is voluntary. This benefit is the moral responsibility of business. As this benefit is supposed to be passed on to society, it can be said to be social responsibility of business.

Definition of Social Responsibility

The following are some important definitions of social responsibility

"Social Responsibility refers to the obligation to pursue those policies to make those decisions or to follow those lines of action which are desirable in terms of objectives and values of our society."

– ***Howard R.***

"Social Responsibility requires managers to consider whether their action is likely to promote the public good, to advance the basic beliefs of our society, to contribute to its stability, strength and harmony".

Peter F. Drucker

17.02 Need for Social Responsibility

Business is expected to be responsible to society due to the following reasons

1. Self-Interest

A business unit can sustain in the market for a longer period only by assuming some social obligations. Normally businessmen recognise that they can succeed better by fulfilling the demands and aspirations of society. People who have had a higher standard of living and have been exposed to an environment conducive to healthy growth make better employees and customers for business than those who are poor, ignorant and oppressed. For example, provision of higher wages and good working conditions motivates workers to work hard and produce more. Labour turnover and absenteeism are reduced.

2. Creation of Society

Business is a creation of society and uses the resources of society. Therefore, it should fulfil its obligations to society. Businessmen should respond to the demands of society and should utilise the social resources for the benefit of the people at large. In the long run a successful business can be built on the foundations of a happy community and a satisfied work force.

3. Social Power

Businessmen have considerable social power. Their decisions and actions affect the lives and fortunes of the society. They collectively determine for the nation such important matters as level of employment, rate of economic progress and distribution of income among various groups. Businessmen should assume social obligations commensurate with their social power. The government controls and regulations intervene in the social power of business in the absence of business taking up social responsibility. It is, therefore, the moral and right thing for business enterprises to assume social obligations.

4. Image in the Society

A business can improve its image in public by assuming social obligations. Good relations with workers, consumers and suppliers help in the success of business. Social obligations improve the confidence and faith of people in a business enterprise.

5. Public Awareness

Now-a-days consumers and workers are well informed about their rights. Consumers expect better quality products at reasonable prices. Similarly, workers desire fair wages and other benefits. They exercise pressure on the employer's through-trade unions. There will be industrial unrest and conflict in society, if business does not fulfil its obligations.

6. Free Enterprise

A business enterprise which accepts and discharges social obligations enjoys greater freedom. For example, the government has passed the Consumer Protection Act to prevent businessmen from indulging in adulteration, black marketing and other anti-social practices. Thus, social responsibilities are essential for avoiding governmental action against business. Such action will reduce the freedom of decision making in business.

7. Law and Order

Any business unit can survive and grow only when there is law and order in society. If business exploits the weaker sections of society for too long, these sections will take the law in their own hands. The resulting chaos will threaten the very survival of business.

8. Moral Justification

In a large country like India, government alone cannot solve all the problems. Business has money and talent with which it can assist the government in solving problems. For example, business can play a vital role in solving regional disparities, unemployment, illiteracy, scarcity of foreign exchanges and such other problems in the country. Moreover, business has created some social problems such as pollution, health hazards, etc. Therefore, business should help society in solving its problems.

9. Socio-Cultural Norms

India has a rich cultural heritage. Businessmen who help in preserving and promoting this heritage will naturally enjoy the patronage of the society and the government. Business should, therefore, promote equality of opportunity, healthy relations with employees and customers, etc.

10. Professionalism

Management of business enterprises is being professionalised. An owner-manager nurses a greater greed for profiteering because all the gains go to him. But a salaried and qualified manager is less likely to be lured because he does not benefit from the profits earned through questionable practices.

11. Trusteeship

Mahatma Gandhi suggested that "those who own money or property should hold and use it in trust for society." Businessmen should run business firms not for their self-enrichment but for the good of the society.

17.03 Arguments For and Against Social Responsibility

Arguments for social responsibility

The rationale for assuming social responsibility lies in the following arguments;

1. Protection of Stakeholders Interest

A business organisation is a coalition of several interest groups or stakeholders. Example – shareholders, customers, employees, suppliers, etc. Business should, therefore, work for the interest of all of them rather than for the benefit of shareholders / owners alone.

2. Promotion of Society

Business is a sub-system of society. It draws support and sustenance from society in the form of inputs. Socially responsible behaviour is essential to sustain this relationship between business and society.

3. Assessment of Social Impact

During the course of its functioning, a business enterprise makes several decisions and actions. Its activities exercise a strong influence on the interests and values of society. Business must fulfil social obligations as a compensation for undermining the legitimate interests of society.

4. Organised Social Power

Large corporations have acquired tremendous social power through their multifarious operations. Social power may be misused in the absence of social responsibility. There should be a equilibrium between social power and social responsibility.

5. Legitimacy

It is in the enlightened self-interest of business to assume social responsibility. Social responsibility legitimises and promotes the economic objectives of business. By improving social life, business can obtain better customers, employees and neighbours. Social responsibility thus builds good citizenship as well as good business.

6. Competence

Business organisations and their managers have proved their competence and leadership in solving economic problems. Society expects them to use their competence to solve social problems and thereby play a leadership role.

7. Professional Conduct

Professional managers are required to display a keen social sensitivity and serve the society as a whole. Social responsibility is one of the professional demands on managers. They adhere to the code of conduct and ethics applicable to respective area of operation.

8. Public Opinion

Adoption of social responsibility as an objective will help to improve the public opinion of business. A good public image is a valuable asset for business. For example maintaining parks, traffic islands and organising awareness camps etc.,

Arguments Against Social Responsibililty

Critics of the social responsibility concept put forward the following arguments:

1. Lack of Conceptual Clarity

The concept of Social responsibility is very vague and amenable to different interpretations. There is no consensus on its meaning and scope. In such a situation, it would be futile as well as risky to accept social responsibility.

2. Dilution of Economic Goals

By accepting social responsibility, business will compromise with economic goals. Business is an economic institution and its only responsibility is to make maximum possible profits for its owners. It would endanger its economic viability by accepting any other responsibility.

3. Lack of Social Skill

Business organisations and their managers are not familiar with social affairs. There are special social service organisations such as Government and Non-Governmental Agencies which can better deal with social problems.

4. Burden on Consumers

If business deals with social problems, cost of doing business would increase. These costs will be passed on to consumers in the form of higher prices or will have to be borne by owners. This would lead to taxation without representation.

5. Responsibility without Power

Business organisations possess only economic power and not social power. It is unjust to impose social responsibilities with social power. If business is allowed to intervene in social affairs it may perpetuate its own value system to the detriment of society.

6. Misuse of Responsibilities

Acceptance of social responsibilities will involve diversion of precious managerial time and talent on social action programmes. It may result in dilution of valuable corporate resources.

7. Lack of Yard-stick

Profitability is the common criteria for decision-making in business. Tampering it with social responsibility would make the decision-making process quite complex and controversial.

8. Improper Role

The proper role of business is to use its resources and energies efficiently so as to earn the best possible return on investment within the confines of law and ethics. Business should concentrate on economic performance leaving social service to other organisations.

9. Over Loading Responsibility

Business organisations are already serving society by providing goods and services, generating employment, developing technology and contributing to public exchequer through tax payments. It would be unjust to overburden them with further responsibilities.

17.04 Kinds of Social Responsibility

Social responsibility of business can broadly be divided into four categories, which are as follows:

Kinds of Social Responsibility

1. ***Economic Responsibility***

   A business enterprise is basically an economic entity and, therefore, its primary social responsibility is economic i.e., produce goods and services that society wants and sell them at a profit. There is little discretion in performing this responsibility.

2. *Legal Responsibility*

Every business has a responsibility to operate within the laws of the land. Since these laws are meant for the good of the society, a law abiding enterprise is a socially responsible enterprise as well.

3. *Ethical Responsibility*

This includes the behaviour of the firm that is expected by society but not codified in law. For example, respecting the religious sentiments and dignity of people while advertising for a product. There is an element of voluntary action in performing this responsibility.

4. *Discretionary Responsibility*

This refers to purely voluntary obligation that an enterprise assumes, for instance, providing charitable contributions to educational institutions or helping the affected people during floods or earthquakes. It is the responsibility of the company management to safeguard the capital investment by avoiding speculative activity and undertaking only healthy business ventures which give good returns on investment.

17.05 Social Responsibility towards Different Interest Groups

After identifying the concept and importance of social responsibility of business the various responsibilities that a business has towards different groups with whom it interacts are discussed below. The business generally interacts with owners, investors, employees, suppliers, customers, competitors, government and society. They are called as interest groups because by each and every activity of business, the interest of these groups is affected directly or indirectly.

Responsibility of Business Towards Different Interest Groups

i. Business	ii. Investors
iii. Employees	iv. Government
v. Competitors	vi. Society
vii. Customers	viii. Suppliers

1. Responsibility towards Owners

Owners are the persons who own the business. They contribute capital and bear the business risks. The primary responsibilities of business towards its owners are to

a. Run the business efficiently.

b. Proper utilisation of capital and other resources.

c. Growth and appreciation of capital.

d. Regular and fair return on capital invested.

2. Responsibility towards Investors

Investors are those who provide finance by way of investment in debentures, bonds, deposits etc. Banks, financial institutions, and investing public are all included in this category. The responsibilities of business towards its investors are :

a. Ensuring safety of their investment,

b. Regular payment of interest,

c. Timely repayment of principal amount.

3. Responsibility towards Employees

Business needs employees or workers to work for it. These employees put their best effort for the benefit of the business. So it is the prime responsibility of every business to take care of the interest of their employees. If the employees are satisfied and efficient, then the only business can be successful. The responsibilities of business towards its employees include:

a. Timely and regular payment of wages and salaries.

b. Proper working conditions and welfare amenities.

c. Opportunity for better career prospects.

d. Job security as well as social security like facilities of provident fund, group insurance, pension, retirement benefits, etc.

e. Better living conditions like housing, transport, canteen, crèches etc.

f. Timely training and development.

4. Responsibility towards Suppliers

Suppliers are businessmen who supply raw materials and other items required by manufacturers and traders. Certain suppliers, called distributors, supply finished products to the consumers. The responsibilities of business towards these suppliers are:

a. Giving regular orders for purchase of goods.

b. Dealing on fair terms and conditions.

c. Availing reasonable credit period.

d. Timely payment of dues.

5. Responsibility towards Customers

No business can survive without the support of customers. As a part of the responsibility of business towards them the business should provide the following facilities:

a. Products and services must be able to take care of the needs of the customers.

b. Products and services must be qualitative

c. There must be regularity in supply of goods and services

After learning about Social Responsibility of the business in this chapter, one can understand the significance of Social Responsibility. The next chapter is about Business Environment and Protection which deals with the organization taking steps to protect both internal and external environment for their sustained growth and development.

Success Story

Corporate Social Responsibility Examples in India

Tata Group

The Tata Group conglomerate in India carries out various CSR projects, most of which are community improvement and poverty alleviation programs. Through self-help groups, it is engaged in women empowerment activities, income generation, rural community development, and other social welfare programs. In the field of education, the Tata Group provides scholarships and endowments for numerous institutions.

Source: www.tata.com

Mahindra & Mahindra

Indian automobile manufacturer Mahindra & Mahindra (M&M) established the K. C. Mahindra Education Trust in 1954, followed by Mahindra Foundation in 1969 with the purpose of promoting education. The company primarily focuses on education programs to assist economically and socially disadvantaged communities. CSR programs invest in scholarships and grants, livelihood training, healthcare for remote areas, water conservation, and disaster relief programs. M&M runs programs such as Nanhi Kali focusing on girl education, Mahindra Pride Schools for industrial training, and Lifeline Express for healthcare services in remote areas.

Source: www.mahindra.com/

Key Terms

Economic Activity, Stakeholders, Prosperity, Standard of living, Resources, Ethics

For Own Thinking

1. To identify ethical and unethical practices of business enterprises
2. To understand the level of discharging Socially Responsiblity practises of business units
3. To analysis the impact of Social Responsibility of Small, Medium and Large scale enterprises in the Society.
4. To clearly distinguish the benefits derived by different stakeholders while discharging of Social Responsibility of business units

For future Learning

1. To evaluate the impact of social responsibility on profitability of business unit
2. To predict methods by which social responsibility can be discharged
3. To depict through pictures, the stakeholders position in a company taking socially responsible activities

Exercise

I7WPK

I. Choose the Correct Answer

1. Which type of Responsibility gives the benefit to the Society out of its profits earned?

(a) Legal

(b) Ethical

(c) Moral

(d) Economic

2. The Stakeholders of Socially Responsible business units are except

(a) Share Holders

(b) Employees

(c) Government

(d) Company

3. Assuming Social Responsibility of business helps the enterprise in

(a) Increase profit

(b) Decrease profit

(c) Sustainability

(d) Equilibrium

4. Socially Responsible business provides goods at

(a) high price

(b) low price

(c) reasonable price

(d)moderate price

5. Social Responsibility towards employees represents the following except

(a) reasonable remuneration

(b) proper facilities

(c) Social security

(d) exploitation

Answers

1. c 2. d 3. c 4. c 5. d

II. Very Short Answer Question

1. Give the meaning of Social power.
2. What is free enterprise?
3. What is Ethical responsibility?

III. Short Answer Question

1. Define the concept of Social Responsibility.
2. List the kinds of Social Responsibility. (any 3)

IV. Long Answer Questions

1. Explain the need for Social Responsibility. (any 5)
2. How do you classify the Social Responsibility?

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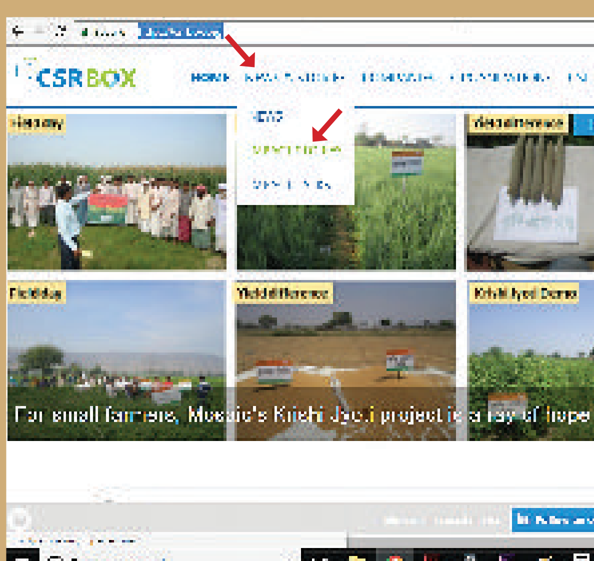
ICT CORNER

EXPLORE CSR PROJECTS

Explore CSR Projects in India

STEPS:

- Open the Browser and type the URL given (or) Scan the QR Code.
- **CSRBOX site will open.** Click on "NEWS & STORIES" and in the drop-down menu Select "IMPACT STORIES"
- Scroll down the stories given and select education related CSR activity success impact story you wish.
- Make a note on it and share it with your friends and teachers about your observation.
- Also Explore CSR PROJECTS in Tamil Nadu.



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*Images are indicative only

UNIT V SERVICE BUSINESS - III

CHAPTER 18 BUSINESS ETHICS AND CORPORATE GOVERNANCE

எப்பொருள் யார்யார்வாய்க் கேட்பினும் அப்பொருள்
மெய்ப்பொருள் காண்ப தறிவு. -குறள் 423

Couplet:
To discern the truth in everything, by whomsoever spoken, is wisdom.

Learning Objectives

To enable the students to

i. have better understanding of the concept of business ethics

ii. identify the Key elements of business ethics

iii. know the code of business ethics

iv. understand the Corporate Governance and International Benchmarks and MNC's in India

In this chapter the important concept of business ethics is discussed briefly. Business ethics is vital for the running of all organisations both in the short and the long run. The Code of Conduct of business units are clearly defined and executed in terms of transparency through corporate Governance. The role of MNCs in the development of the economy is explained along with the features. The need for international benchmarking is also highlighted.

18.01 Concept of Business Ethics

'Business houses need to go beyond the interests of their companies to the communities they serve.'

Ratan Tata, Former Chairman of the Tata group

'A business that is in the making of only money is a poor kind of business.'

Hendry Ford, Founder of Ford Motor Corporation.

Ethics is derived from the Greek word 'ethos' which means a person's fundamental orientation towards life. It governs the behaviour, derived from the moral standards which help to determine right or wrong, good or evil. Ethical behaviour is the acts consistent with the moral standards or codes of conduct established by society. It may change over time and differ from culture to culture. For example, political bribes or payoffs may be acceptable in one culture but not in other. Ethical issues are inevitable in business.

Business ethics may be defined as a set of moral standards to be followed by owners, managers and business people. These standards determine the conduct and behaviour of business people. Business ethics reflects the conduct in the context of business.

Business Ethics

Business exists to supply goods and services to the people from social point of view but from individual point of view, the primary objective of any business unit is to make profit. The individual objective should not be in conflict with societal objective. These two objectives normally contradict each other, as one business enterprise may be good in individual objective and bad at societal objective and vice versa. This raises the question of what is right and what is wrong. The subject matter of ethics is concerned with establishing linkages between individual good and social good.

Ethical standards are often enacted into laws. For example charging fair prices to customers, using fair weights for measurement of commodities giving fair treatment to workers, earning reasonable profits etc.

All business units have realised that ethics is vitally important for the existence and progress of the business as well as the society. It is very important as it improves public image, earns public confidence, and leads to greater success. Ethics and profits go together in the long run. It enhances the quality of life, standard of living and business.

18.02 Key Elements Of Business Ethics

Some of the basic elements of business ethics while running a business enterprise are:

1. Top Management Commitment

Top management has a very important role to guide the entire organization towards ethical behaviour. The top level personnel in any organisation should work openly and strongly committed towards ethical conducts and guide people working at middle and low level to follow ethical behaviour.

2. Publication of a "Code"

Generally organisations formulate their own ethical codes for the conduct of the enterprise; it should followed by the employees of the organisation. The organisation principles are defined in the written document called code. The code of conduct covers various areas such as health and safety in the work place, fair dealing in selling and marketing activities, ethical practices in the business etc.

3. Establishment of Compliance Mechanism

To make sure that actual decisions match with a firm's ethical standards, suitable mechanism should be established. Any organisation following ethical codes in training, recruitment, selection etc., is sure to be profitable. The organisation must provide for an environment where the employees are to free to report about the matters of unethical behaviour.

4. Involving Employees at All Levels

It is the employees at different levels who implement ethics policies to make ethical business a reality. Therefore, their involvement in ethics programmes becomes a must. For example small group of employees can be formed to discuss the important ethics policies of firms and examine attitudes of employees towards these policies.

5. Measuring Results

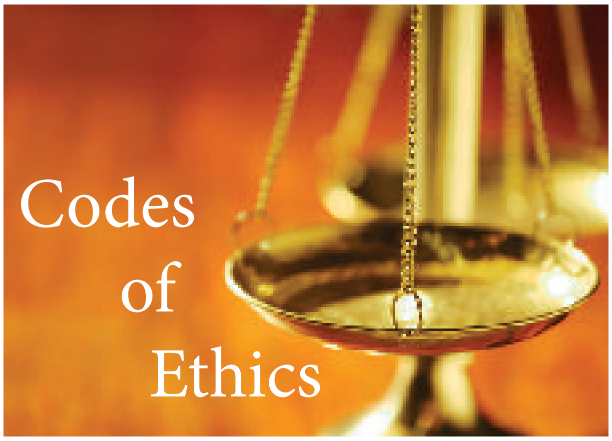
The organisations from time to time keep a check on ethical practise followed. Although it is difficult to accurately measure the end results of ethics programmes, the firms can certainly audit to monitor compliance with ethical standards. The top management team and other employees should then discuss the results for further course of action.

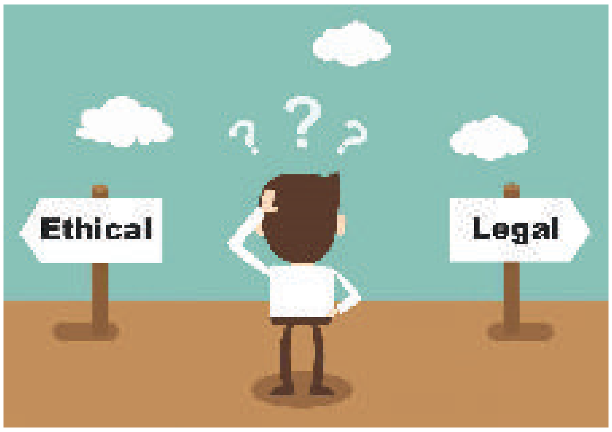
18.03 Code of Business Ethics

Code of ethics documents the generally accepted principles of ethical conduct. They are statements of values and principles which define the purpose of an organisation. It gives a clear picture of the standards that employees should follow .It guides them in decision making.

The code of business ethics can include the following:

1. To offer goods at fair prices.
2. To supply quality goods and not to deal in spurious and sub standard products.
3. To listen to consumer's complaints and to reduce them.
4. Not to raise the price of its products unjustifiably.
5. Not to resort to hoarding and black marketing.
6. Not to resort to price cutting with the sole aim of killing competition.
7. Not to issue advertisement containing false information or exaggerated claims.
8. To pay fair wages to its employees and not to exploit them.
9. To provide congenial work atmosphere.
10. To design production process in such a way as to reduce environmental pollution.
11. To keep proper books of accounts and records.
12. To pay taxes regularly.
13. Not to overlook Government rules and regulations even at the time of incurring losses.





18.04 Corporate Governance

'The proper governance of companies will become as crucial to the world economy as the proper governing of countries.'

Jeames Wolfenson,
President of World Bank, 1999

Meaning of Corporate Governance

Corporate Governance is the system by which businesses are directed and controlled in the best interests of all stakeholders. Corporate Governance lays emphasis on ethics, fair business practices, transparency, discloser and conduct of business for the benefit of all stakeholders.

Corporate governance specific the rights and liabilities of different group of people like the chief executives, directors of the board, managers of different departments and other stakeholders. This helps to provide the structure through which the objectives of the company formulated and their performance is monitored.

Corporate Governance maintains balance among individual goals, societal goals, economic goals and social goals. For example companies like Infosys, Wipro, Reliance, Hindustan Uni Lever Ltd. etc. have implemented corporate governance codes which ensure ethical and efficient conduct leading to their development.

Definitions

There are different definitions contributed by various authors. Some important definitions are as follows.

"Corporate governance is about promoting fairness, transparency and accountability."

-World Bank

"Corporate governance is defined as the system by which companies are directed and controlled."

- Cadbury committee

Benefits of Corporate Governance

Balanced economic development is made possible through transparent management under corporate governance. All Stakeholders interests are protected and promoted through corporate governance. Some of the benefits of corporate governance are as follows

1. Good corporate governance enables corporate success and economic development.
2. Ensures stable growth of organizations.
3. Aligns the interests of various stakeholders.
4. Improves investors' confidence and enables raising of capital.
5. Reduces the cost of capital for companies.
6. Has a positive impact on the share price
7. Provides incentive to managers to achieve organizational objectives.
8. Eliminates wastages, corruption, risks and mismanagement.
9. Improves the image of the company.
10. The organization is managed to benefit the stakeholders.
11. Ensures efficient allocation of resources
12. Creates a strong brand as an ethical business.

Multinational Corporations in India

Meaning

Indian economy is growing over the lengths and breaths and establishes businesses earning huge profit. Companies have grown in their size (capital and number of employees) competing with different countries companies. The concept of Multinational Corporation has gained significance over a period of time as it has its business globally in different countries.

Definition

MNC is defined to be an enterprise operating in several countries but managed from one country.

A Multinational corporation is an organization doing business in more than one country. It engages in various activities like exporting, manufacturing in different countries.

MNC is company which functions with a head quarters based in one country, while other facilities are based in other location.

Any company is referred to as a Multinational company or corporation (MNC) when that company manages its operation or production or service delivery from more than a single country. It has its headquarter based in one country with several other operating branches in different other countries. The country where the head quarter is located is called the home country whereas; the other countries with operational branches are called the host countries. Apart from playing an important role in globalization and international relations, these multinational companies even have notable influence in a country's economy as well as the world economy. The budget of some of the MNCs are so high that at times they even exceed the GDP (Gross Domestic Product) of a nation.

Features of MNCs

The main features or elements of MNCs are as follows

1. Considers opportunities throughout the globe though they do the business in a few countries.
2. To invest considerable portion of their assets internationally.
3. They are huge industrial/business organisation.
4. It engages in international production and operates plants in a number of countries.
5. They take managerial decisions on a global perspective.
6. They produce in one or a few countries and sell them in most of the countries.
7. Their international operations are integrated into the corporations overall business.

Why MNC's in India

The reasons for so many MNC's in Indian are as follows

1. India has a huge market
2. It is one of the fastest growing economies in the world.
3. Favorable policies of the government towards FDI.
4. Financial liberalization of the country after 1991.
5. Government encourages and makes continuous efforts to attract foreign investment by relaxing policies.

Highlights (2015)

India ranks 10^{th} in the world in factory output

The manufacturing sector accounts for 27.6% GDP

Privatisation of certain public sector industries

Liberlisation also attracted MNC's and encouraged local entrepreneurs

Indian stands 15^{th} in services output

Increased demand from foreign consumers for Indian products and services

India has an extensive network of undersea fibre-optic cables leading to India becoming the centre for outsourcing of business process

India has become big employment generator especially amongst young graduates.

India has witnessed sustained economic development as envisioned by our forefathers

Top MNC's in India

Following are the names of some of the most famous multinational companies

The entry of MNC's into India have proved quite beneficial for the growth and development of Indian economy providing employment opportunities for the young generation.

IBM	Microsoft	
Pepsi Co	Sony	
Vodafone	Reebok	Nokia

Key Terms

Behaviour	Moral	Mechanism
Atmosphere	Fair Prices	Monitor

For Own Thinking

1. Illustrate the ethical practices followed by different reputed organisation giving practical examples.
2. Create case studies concerning the existing famous organisation following ethical practices quoting their real life practice
3. Identifying ethical codes based on which organisation exits, for long run and short run, justifying the adherence of code of ethics.

For Future Learning

1. Money earning cannot be sole objective of business or life.
2. The mind of students to accept that ethics and consideration for environment, law etc can lengthen the income earning of an individual or business

Exercise

I. Choose the Correct Answer

1. Which of the following helps in maximising sale of goods to society?

a) Business success

b) laws and regulations

c) Ethics

d) Professional management

2. **Ethics is important for**

a) Top management

b) Middle level managers

c) Non managerial employees

d) All of them

3. **Which of the following does not ensure effective ethical practices in a business enterprise**

a) Publication of a code

b) Involvement of employees

c) Establishment of compliance mechanisms

d) none of them

4. **The role of top management is to guide the entire organisation towards**

(a) General behaviour

(b) Organisavtion behaviour

(c) Ethically upright behaviour

(d) Individual behaviour

5. **The ethical conduct of employees leading to standard practices results in**

(a) good behaviour
(b) bad behaviour
(c) ethical behaviour
(d) correct decision making

Answers

1.c 2.d 3.a 4.c 5.d

II. Very Short Answer Questions

1. What is Ethics?
2. Write any two key elements of Business Ethics.
3. Define Corporate governance.

III. Short Answer Questions

1. What do you mean by the concept of Business Ethics?
2. Why MNC's in India? (any 3)

IV. Long Answer Questions

1. Explain the different key elements of Business Ethics.
2. What are the benefits of Corporate Governance? (any 5)

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UNIT VI BUSINESS FINANCE

CHAPTER 19 SOURCES OF BUSINESS FINANCE

குன்றேறி யானைப்போர் கண்டற்றால் தன்கைத்தொன்று
உண்டாகச் செய்வான் வினை. -குறள் 758

Couplet:
An undertaking of one who has wealth in one's hands is like viewing an elephant-fight from a hill-top.

Learning Objectives

To enable the students to
i. explain the meaning, nature and significance of business finance
ii. explain the need for business finance
iii. classify the various sources of business finance
iv. understand the importance of savings and investments

Introduction

The previous chapter highlighted the importance of insurance. The present chapter enlightens the students on the concept of Business Finance. Need for the Business Finance, sources of funds and the importance of savings and personal investment avenues, are briefly discussed in this chapter.

"Finance is the lifeblood of any business." No business enterprise can function without finance. Business enterprises

need finance for fixed and working capital requirement. Fixed capital requirements include purchase of plant, machinery, furniture, fixtures, vehicles, and so on, while working capital requirements include purchase of raw materials, payment of salary and wages, incurring operating expenses like telephone bills, carriage inward and outward, electricity charges, premium, stationery, etc. Owner or promoter has to estimate the business finance and accordingly look for various sources for financing the operations of the enterprises. The term sources of funds denote the various avenues of mobilisation of funds for a concern. This chapter throws light on each source of capital.

19.01 Meaning and Nature of Business Finance

Meaning

The term business finance denotes the economic resources employed in business enterprises. This term includes money and credit employed in the business. Business finance is mainly concerned with arrangement of cash and credit for the business enterprises to carry out their day to day operations smoothly.

It is clear from the definitions given above that the term 'business finance' is mainly concerned with not only acquisition of funds from various sources but also with effective and efficient utilisation of the finance mobilised therefrom.

Definition

"The finance function is the process of acquiring and utilizing funds by a business."

– ***R.C. Osborn***

"Finance is that business activity which is concerned with the acquisition and conservation of capital fund in meeting the financial needs and overall objectives of business enterprises."

- ***B.O.Wheeler***

Nature and Significance of Business Finance

Nature of Business Finance

The following characteristics can be derived from the above definitions.

1. Business finance comprises of all types of funds namely short, medium and long term used in business.
2. All types of organisations namely small, medium and large enterprises require business finance.
3. The volume of business finance required varies from one business enterprise to another depending upon its nature and size. In other words, small and medium enterprises require relatively lower level of business finance than the large scale enterprises.
4. The amount of business finance required differs from one period to another. In other words the requirement of business finance is heavy during the peak season while it is at low level during the dull season.
5. The amount of business finance determines the scale of operations of business enterprises.

Significance of Business Finance

Business enterprise can function effectively and efficiently only with adequate business finance. It cannot expand its business operations without business finance. The success of any business firm depends, to a larger extent, on the manner in which it mobilizes, uses and disburses its funds.

The following points highlight the significance of business finance.

1. A firm with adequate business finance can easily start any business venture.
2. Business finance helps the business organisation to purchase raw materials from the supplier easily to produce goods.

3. The business firm can meet financial liabilities like prompt payment of salary and wages, expenses, etc., in time with the help of sound financial support.
4. The sound financial support enables the enterprises to meet any unexpected or uncertain risks arising from business environment efficiently. For example economic slowdown, trade cycles, severe competition, shift in consumer preference, etc.
5. Sound financial position empowers the enterprise to attract talented man power and introduce latest technology.

19.02 Sources of Business Finance

Classification of Sources of Finance

Business finance is classified into three types with reference to time pereiod i.e. Long term finance (more than 5 years), Medium term finance (above 1 year but below 5 years) and Short term finance (within one year) for carrying on business operations. Long term finance can be mobilized by issue of shares and debentures, term loans from commercial banks and financial institutions, and retained earnings. Medium term finance can be mobilized by public deposits, leasing, medium term loans from banks and financial institutions. Short term fiancé can be raised through public deposits, trade credit, customer advance, , hypothecation, cash credit, bank overdraft, pledge, mortgage etc.

The various sources of business finance can be classified into three categories on the basis of i) period basis ii) ownership basis iii) source of generation basis

On the basis of period

The different sources of finance can be further grouped into three categories on the basis of period

1) Short term finance 2) Medium term finance 3) Long term finance

Sources of Short Term Finance

Short term funds are those sources which are required by the business firms for a period of within one year. Some of the important sources of short term finance are briefly explained below.

1. Loans and Advances

Loan is a direct advance made in lump sum which is credited to a separate loan account in the name of borrower. The borrower can withdraw the entire amount in cash immediately. It can be repaid in one or more installments. But the interest on loans and advances is calculated on the whole of the amount borrowed right from the date of sanction. It may be secured or unsecured. Loans and advances are usually sanctioned by pledge of specific assets like Fixed Deposit Receipts, Document of Title to the Goods, Shares, Debentures, etc.

2. Bank Overdraft

Bank overdraft refers to an arrangement whereby the bank allows the customers to overdraw the required amount from its current deposit account within a specified limit. Interest is charged only on the amount actually overdrawn.

3. Discounting Bills of Exchange

When goods are sold on credit, the suppliers generally draw bills of exchange upon customers who are required to accept it.

The duration of such bills of exchange may be ranging from 15 days to 180 days. Instead of holding the bills till the date of maturity, borrowers generally prefer to get them discounted with the bank. Discounting bills of exchange refers to an act of selling a bill to obtain payment for it before its maturity.

4. Trade Credit

Trade credit is the credit extended by one trader to another for the purpose of purchasing goods and services. Purchaser need not pay money immediately after the purchase. Such credit appears in balance sheet as Trade Creditors, or Accounts Payable. Trade credit is very simple and convenient method of raising short term finance. There is no formality involved in availing this facility. There is no need to give any security for trade credit. It is said to be more economical than bank loans.

5. Pledge

A customer transfers the possession of an article with the creditor (banker) and receives loan. Till the repayment of loan, the article is under the custody of the borrower. If the debtor fails to refund the loan, creditor (banker) will auction the article pawned and adjust the outstanding loan from the sale proceeds.

6. Hypothecation

This is loan taken by depositing document of title to the property with the banker. Of course the physical possession of asset property is with the borrower. If the borrower fails to repay the loan amount, the article hypothecated will be sold in auction by the banker concerned. Business people *hypothecate* goods or equipment to get this type of loan. It is a loan taken on the security of **movable asset**.

7. Mortgage

This is a type of loan taken from the bank by lodging with the banker title deeds of **immovable assets** like land and building. Business people raise loans by depositing the title deeds of the properties with the bank.

8. Loans Against the Securities

Banks accept various types of securities like fixed deposit receipt, book debts, insurance policies, supply bills, shares debentures, bonds of company, document of title to the goods like railway receipt, bill of lading, trust receipt, warehouse keeper's receipt, book debt, and so on, and provides loan on the basis of the aforesaid securities.

9. Clean Loan

Banks provide clean loan to certain customer of outstanding credit worthiness on the basis of their character, capacity and capability. It simply grants loan without any physical security. In other words clean loan is loan given without any security or with personal security.

10. Commercial Paper (CP)

Commercial paper (CP) is an unsecured money market instrument in the form of a promissory note. Corporates, Primary Dealers (PD), and All India Financial Institutions are eligible to issue Commercial Paper. It was introduced in India in 1990 under Section 45W of the Reserve Bank of India Act. It is issued by a firm to raise funds for a short period. It can be issued for maturities between a minimum of 7 days and a maximum of up to one year from the date of issue.

11. Hire Purchase Finance

Small scale firms can acquire industrial machinery, office equipments, vehicles etc., without making full payment through hire purchase. With the help of assets acquired through hire purchase, they can produce and sell. From the earnings, payments can easily be made in installments. Ultimately the ownership of assets can be acquired. Now several agencies like National Small Industries Corporation (NSIC) provide machinery and equipments to small scale units on hire purchase basis.

12. Factoring

Factoring is one of the methods of raising business finance through sale or mortgage of book debts. Under this method, business concerns sell the accounts receivable to a finance company called a factor at a discount.

Sources of Medium Term Finance

1. Loans from Banks

When the bank lends for a period ranging from more than one year to less than five years, it is called medium term loan. All aspects of bank finance have been discussed under the head long term sources of finance.

2. Loan from Financial Institutions

Where the financial institutions lends for a period ranging from more than one year to less than five years, it is called medium term loan. All aspects of institutional finance have been discussed under the head long term sources of finance.

3. Lease Financing

Lease financing denotes procurement of assets through lease. For many small and medium enterprises, acquisition of plant and equipment and other permanent assets will be difficult in the initial stages. In such a situation Leasing is helping them to a greater extent. Leasing here refers to the owning of an asset by any individual or a corporate body which will be given for use to another needy business enterprise on a rental basis.

The firm which owns the asset is called 'Lessor' and the business enterprise which hires the asset is called 'Lessee'. The contract is called 'Lease'. The lessee pays a fixed rent on agreed basis to the lessor for the use of the asset. The terms and conditions like lease period, rent fixed, mode of payment and allocation of maintenance, are mentioned in the lease contract. At the end of the lease period, the asset goes back to the lessor. Alternatively lessee can own the asset taken on lease by payimg the balance of price of asset concerned to lessor. Hence lease finance is a popular method of medium term business finance.

Sources of Long Term Finance

Long term sources of funds refer to those sources which are required by the business firms for a period exceeding five years. The various sources of long term business finance are briefly explained below.

1. Shares

Corporate enterprises generally obtain capital mainly from share capital which is divided into small units called shares. Each share has a nominal value. The Indian Companies Act 2013 describes a share "to be a share in the share capital of a company". The person holding a share is called shareholder who has the interest in the assets and profit of the company. There are two types of shares namely Equity shares and Preference shares.

i) Equity Shares

The fund raised by issuing equity shares is termed as equity share capital. Equity share is the most important source of raising long term capital by a company. These shares do not carry any special or preferential rights in the matter of payment of annual dividend and repayment of capital at the time of winding up . Equity shareholder enjoys more voting rights in proportion to number of shares held by them. Thus they take part in the management of the company.

ii) Preference Shares

The fund raised by issue of preference shares is called preference share capital. Preference shares are those shares which enjoy priority regarding payment of dividend at a fixed rate out of the net profits of the company. They will get their dividend every year before any dividend is paid to equity shareholders. They will have a right to get their settlement before the claims of equity shareholder are settled at the time of liquidation of company. However they do not have voting rights.

2) Debentures

Debentures are an important instrument for raising long term debt capital. A company can raise funds through issue of debentures which bear a fixed rate of interest. The individual or person subscribing to debentures is called debenture holder. An entity raising funds through debenture has to pay interest at the stipulated date whether it earns profit or loss. Failure to pay interest leads to liquidation of the company. Debenture holders do not have voting rights.

3) Retained Earnings

Retained earnings refer to the process of retaining a part of net profit year after year and reinvesting them in the business. It is also termed as ploughing back of profit. An individual would like to save a portion of his/her income for meeting the contingencies and growth needs. Similarly profit making company would retain a portion of the net profit in order to finance its growth and expansion in near future. It is described to be the most convenient and economical method of finance.

4) Public Deposits

Under this method, companies invite public deposits by giving advertisement in the media. It offers deposit schemes for a longer tenure. Person interested in making public deposit has to undergo a simple formality. The interest rates offered by companies on public deposits are relatively higher than the bank. Public deposits are perceived to be economical for the company since the interest rate on deposits is less than the cost of borrowing from the bank.

The company need not offer any of its assets as security on accepting public deposits. Moreover the control of the company is not diluted as the deposit holders do not enjoy the voting rights.

5) Long Term Loan from Commercial Banks

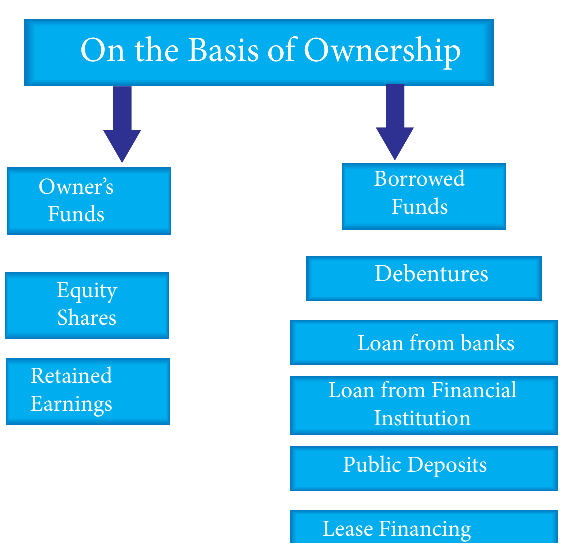
Commercial banks are important sources of raising business finance for various purposes as well as for different time periods. Banks in modern times offer long tenured loans for a period beyond 5 years also. The long term loan taken from banks can be repaid either in installment or in one lump sum. Banks provide long term loans on the security of assets of the business firms. Nowadays the formalities for taking long term loans are simplified by the Reserve Bank of India.

6) The Loans from Financial Institutions

Central and State Governments have established various financial institutions in India to provide finance to business enterprises for a longer period. These institutions aim at promoting the industrial development of a country. In addition to loan assistance, they conduct market surveys, provide technical assistant and supply managerial talents to borrowing enterprises to manage the companies. They mainly provide large funds for longer period for financing expansion, reorganisation and modernisation of an enterprise. They allow longer repayment period to repay the loan. Hence the borrowing companies do not feel the stress of repayment. Financial institutions provide term loans mostly to highly rated corporates by the credit rating companies.

On the Basis of Ownership

Business finance can be divided into two categories based on ownership of funds.



1. Owner's Funds

Owner's funds mean funds which are provided by the owner of the enterprises who may be an individual, or partners or shareholders of a company. The profits reinvested in the business (ploughing back of profit or retained earnings) come under owner's funds. These funds are not required to be refunded during the life time of business enterprise. It provides the owner the right to control the management of the enterprise.

2. Borrowed Funds

The term 'borrowed funds' denotes the funds raised through loans or borrowings. For example debentures, loans from banks and financial institutions, public deposits, trade credit, lease financing, commercial papers, factoring, etc. represent borrowed funds.

1. These borrowed sources of funds provide specific period before which the fund is to be returned.
2. Borrower is under legal obligation to pay interest at given rate at regular intervals to the lender.
3. Generally borrowed funds are obtained on the security of certain assets like bonds, land, building, stock, vehicles, machinery, documents of title to the goods, and the like.

On the Basis of Generation of Funds

The sources of funds can be grouped into two categories based on generation.

1. Internal Sources

This includes all those sources generated from within the business enterprises. For instance retained earnings, collection from receivables (trade debtors and bills receivable), surplus from disposal of old assets and so on. These sources can meet only limited needs of business enterprise.

2. External Sources

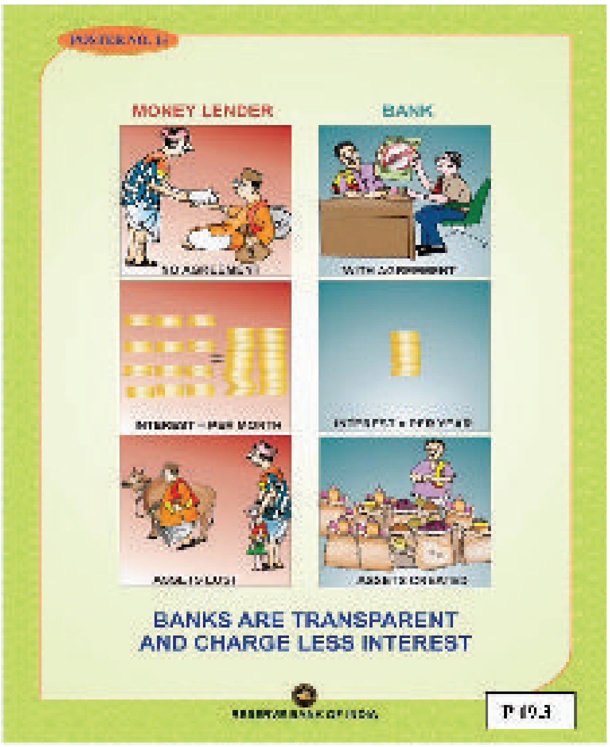
External sources of funds include all those sources which generate funds from outside the business enterprise. For example issue of shares and debentures, borrowings from banks and financial institutions, public deposits, factoring, leasing, hire purchase, etc.

19.03 Factors Influencing Choice of Business Finance

There are various factors influencing choice of source of business finance. These factors are briefly discussed below

1. Cost

Business enterprises have to analyse the cost of mobilising and utilizing the funds. For



Informal money lenders

There are certain groups or individuals in urban and rural areas of Tamil Nadu, and all over India, who lend money informally. They follow unethical practices of lending by

i) Charging very high rate of interest on daily basis.
ii) Collecting back the loans through money and muscle power.
iii) Ill-treating the borrowers to the core, sometimes leading to suicides
iv) Being highly choosy about the borrowers rather than the project financed.

The RBI and the respective governments in various states have come up with many legal control measures, but still they are beyond the reach of such measures. For example with the rapid growth in information technology personal financing has undergone a sea-change. Peer-to-peer lending is very popular among urban salaried class. Sites like https://www.faircent.com/ enable salaried people to take an advance at a nominal interest in case of emergencies.

Micro finance or financing small business enterprises today has to be viewed from the 'ethical' sources than the 'informal' sources that are totally unscrupulous in their financing practices. So Entrepreneurs can approach sites like https://udyamimitra.in to apply for MSME, 'STAND UP INDIA' and MUDRA loans.

The website portals like https://www.vidyalakshmi.co.in/ enable the students to approach for Education Loan in moderate rate of interest for further studies in various banks and financial institutions. The portal helps in providing linkages to National scholarship Portal.

instance where the interest rate is relatively lower, public deposits, debentures, term loan etc. may be desirable options.

2. Financial Capacity of the Firm

Financially sound enterprises have capacity to pay interest promptly and return the capital at the stipulated time. Such enterprises can go for borrowed source. On the other hand, if the firm is not financially stable, it has to depend on owned sources of fund.

3. Forms of Organisation

The choice of source of fund depends on the form of organisation. Sole proprietor and partnership firms cannot issue shares and debentures. They have to depend on short term sources like bank finance, leasing, hire purchase, factoring, etc. On the other hand Companies, Government organisations and Co operative organisations mobilise funds both from long term sources like shares, debentures, public deposits etc. and from short term sources.

4. Time Period

The period for which business finance is required determines the suitable source. For instance, where funds are required for shorter period, bank finance like overdraft, cash credit, bill discounting, mortgage, pledge, leasing, hire purchase, factoring and so on, are suitable sources. Funds required for longer period can be tapped from issue of shares, debentures, bonds, term loan and the like.

5. Risk Factor

Owned funds do not invite any risk while using borrowed funds entails a lot of risk. The probable default in paying interest and capital may lead to the liquidation of business enterprises besides damaging the reputation of the business concern in the business world.

6. Control

Equity shareholders are real owners of corporate enterprises. They exercise complete control over the management of the company. If the existing shareholders do not like to lose their control, they must not issue more equity shares to supplement the financial resources. Contrarily borrowed sources of funds will not disturb the control exercised by the company management. Hence borrowed source is suitable for maintaining the administrative control of the company.

7. Stage of Development

A new business enterprise finds it hard to mobilise business finance than an established firm. Therefore it may have to rely on owned sources in the initial stage. Once the business enterprise has established itself in the business world, they can tap borrowed source of funds and offer its assets as security there for.

8. Credit Worthiness of Firms

Some sources of funds like debentures and creditors require the business firms to mortgage the assets. This hurts the credit worthiness of the business concern in the financial market. Contrarily business concerns do not have to mortgage its assets when they mobilise funds through sources like share capital, retained earnings, unsecured loans, etc. and thereby maintaining good image in the financial market.

19.04 Savings - Importance of Savings

The concept of savings plays an important role in economic development of any country. Saving is defined as the difference between income and consumption. In other words it points to sacrifices of some sort. Earning money may be easy; but using it in the right way as well as saving it for the future is pretty tough. Savings is important for each and every one of us to lead a peaceful life. Saving paves way for a happier future. "World Savings Day" was promoted all over the world to emphasis the value of savings. October 31 has been declared as the "World Savings Day" by the International Savings Bank Congress.

Following Points Highlight the Importance of Savings

Money invested in deposit account, small savings schemes, mutual funds, life insurance policies, Bonds of Government companies, shares etc. lead to overall economic development of a country.

1. Money invested in bank deposits facilitates employment generation in various sectors of economy and poverty alleviation.
2. The savings invested in bank deposits lead to credit creation in the country which in turn promotes industrial and agricultural development in a country.

"SAVE MONEY TO SAVE ALL"

3. Savings invested in government bonds and various institutions helps in great measure in building in strengthening the infrastructure facilities in a country.
4. The country with higher savings can easily face the consequences of economic recession.
5. The bad consequences of inflation can be met easily with strong savings. As a result the evil effect of soaring prices can be controlled.

19.05 Personal Investment Avenues

People invest the savings to gain financial security. They are investing their savings in a various investment avenues for various purposes. They may invest in various securities and wait for a stipulated period to get back their investments with higher value addition.

There are three aspects which need to be considered before investing the money namely liquidity, profitability, and safety. In other words some investments can be easily and readily encashed in the market without any loss. Such investments are called liquid investments, for example bank deposits, government bonds, mutual funds, precious metals like gold, silver, platinum etc. while certain other investments cannot be liquidated immediately but they may fetch higher returns at maturity. For example shares, real assets, debentures, public deposits, fixed deposits, money back insurance policies come under this category.

Certain other investments offer higher income earning prospects but they are totally unsafe as in the case of gambling, horse race, lottery, speculation and so on and so forth. Therefore an individual investor has to park the surplus funds judiciously so as to balance the liquidity, safety and profitability.

Following are some of the investment options available to individual investor

1. Public Provident Fund (PPF)

It is the safest long-term investment option for the investors in India. It is totally tax-free. PPF account can be opened in bank or post office. The money deposited cannot be withdrawn before 15 years and an investor can earn compound interest from this account. However the investor can extend the time frame for the next five years if the investor does not opt to withdraw the amount matured for payment at maturity date. PPF investor can take loan against PPF account when he/she experiences financial difficulties.

2. Mutual Funds

An individual investor who wants to invest in equities and bond with a balance of risk and return generally can invest in mutual funds. Nowadays people invest in stock markets through a mutual fund. Systematic investment plan is one of the best investment options in India.

3. Direct Equity or Share Purchase

An individual can opt for investment in shares. But he has to analyse the market price of various shares traded in stock exchange, reputation of the company, consistency in the payment of dividend, the nature of the project undertaken by the company, growth prospects of industry in which a company is operating, before investing in shares. If the investment is made for a long time, it may yield good return. However there is equally risky to invest in shares as there is no guaranteed return therein.

4. Real Estate Investment

Real estate is one of the fastest growing sectors in India. Buying a flat or plot is supposed to be the best decision amongst the investment options. The value of the real asset may increase substantially depending upon the area of location and other support facilities available therein. However an investor in real estate has to be cautious and circumspect in verifying the genuineness of the title deeds before investing in real estate assets and also the reputation of seller of real assets.

5. Investing in Metals

Investment in metals like gold, silver and platinum is one of the oldest and evergreen investment products. The values of the metals rise slowly and steadily in line with the dynamic market conditions. But investors can liquidate the metals immediately in the market without any loss. Besides an investor can opt for investment format, like gold deposit scheme, gold ETF (exchange-traded fund), Gold Bar, Gold mutual fund etc., to get benefit in the short period of time.

6. Post Office Saving Schemes

There are different types of postal small savings schemes namely Post Office Savings Account, Post Office Recurring Deposit Account (RD), Post Office Fixed Deposit Account (FD/TD), Post Office Monthly Income Account Scheme (MIS), Senior Citizens Saving Scheme (SCSS) Public Provident Fund Account (PPF), National Savings Certificates (NSC), Kisan Vikas Patra (KVP), Sukanya Samriddhi Account (SSA). Investors can choose the appropriate postal schemes as per their needs.Postal investment schemes is the safest investments

7. Public Deposits

Public deposits are more beneficial than the fixed deposit in the bank, in the matter of yielding good return. An investor has to select the investment period very carefully. He/she is not allowed to withdraw money before maturity. However the public deposits collected by companies and institutions do not offer any insurance benefits. It does not come under the control of the Reserve Bank of India. The investors who are willing to invest for long term can opt for public deposits.

8. Bonds

Bonds are one of the ideal investment options for those investors who would like to invest their hard earned money safely. Bonds are issued both by government and public and private sector companies and financial institutions. Mostly there are four types of bonds sold in India namely Government bonds, Corporate bonds, Banks and other financial institutions bond and Tax saving bonds. The term bond is used for the debt collected by the government while the term debenture is used when the corporates collect debt capital from the public.Investment in bonds is totally risk free.

9. Unit Linked Insurance Plans (ULIP)

ULIP is a life insurance linked product, which provides risk cover for the policy holder along with investment options to invest in any number of qualified investments such as stocks, bonds or mutual funds.

10. Bank Deposits

Fixed deposits (FD) enable the investor to invest the money for a specific period. The Fixed deposit can be opened from a minimum period of 7 days to a maximum period of 10 years. The fixed deposit holder can take loan against the fixed deposit receipt. The depositor cannot withdraw the fixed deposits before the maturity date.

Recurring deposit (RD) account is another investment option for those people who earn regular income. This deposit can be opened for a minimum period of 1 year to a maximum period of 10 years. The Recurring deposit holder can take loan against the instalments paid.

Key Terms

Business Finance	Trade Credit
Leasing	
Personal Savings	
Shareholders	Mortgage

Case Study

Gokul Steel Ltd is a large and creditworthy company that manufactures steel for the Indian market. It now wants to cater the Asian market and decides to invest in new hi-tech machines. Since the investment is large, it requires long term finance. It decides to raise funds by issuing equity shares. The issue of equity shares involves huge floatation cost. To meet the expenses of floatation cost, the company decides to tap money market.

a) Name and explain the money-market instrument the company can use for the above purpose.

b) What is the duration for which the company can get funds through the instrument?

c) State any other purpose for which this instrument can be used.

For Own Thinking

1) Working of chit funds

2) Finance for bonded labour

For Future Learning

1) Export finance for small entrepreneurs

2) Financing software companies run by young graduates

Exercise

I. Choose the Correct Answer

1. What is defined as the provision of money at the time when it is required?

a. finance

b. bank

c. cash management

d. none of these

2. Internal sources of capital are those that are ________________

a generated through outsiders such as suppliers

b. generated through loans from commercial banks

c. generated through issue of shares

d. generated within the business

3. Debenture holders are entitled to a fixed rate of __________

a. Dividend

b. Profits

c. Interest

d. Ratios

4. Public deposits are the deposits which are raised directly from ______

a. The public

b. The directors

c. The auditors

d. The owners

5. Equity shareholders are the __________ of a company

a. Creditors

b. Owners

c. Debtors

d. Employees

Answers

1. a 2. d 3. c 4. a 5. b

II. Very Short Answer Questions

1. Write a short notes on Debentures.
2. Name any two sources of funds classified under borrowed funds.
3. Write any two examples of Post Office Savings Schemes.

III. Short Answer Questions

1. Define Business Finance.
2. What is Pledge?
3. Classify the sources of business finance on the basis of period.

IV. Long Answer Questions

1. Explain the kinds of sources of short term finance. (any 5)
2. Explain any five personal investment avenues.

Project work

1. Visiting a bank in your locality and find out from them about the various ways in which they provide finance to small business enterprises.
2. Kumaran had started his leather bag business as a sole proprietor, with a capital of ₹10,00,000/-. Now, after five years, he has decided to expand his business in the form a company. As a commerce student, give your suggestions to find out the various long term financial sources to generate funds for his company.

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UNIT VI BUSINESS FINANCE

CHAPTER 20 INTERNATIONAL FINANCE

BHJ00

Learning Objectives

To enable the students to

i. state the importance of International finance

ii. explain the concept of Foreign Direct Investment

iii. analyse the advantages and disadvantages of FDI

iv. state the meaning of Global Depository Receipt and American Depository Receipt

20.01 Introduction

International finance is a branch of financial economics that deals with the monetary interactions that occur between two or more countries. This section is concerned with topics that include foreign direct investment and currency exchange rates. It also involves issues pertaining to financial management, such as political and foreign exchange risk that comes with managing multinational corporations.

Importance of International finance

International finance plays a pivotal role in the international trade and in the sphere of exchange of goods and services among the nations.

The following points highlight the importance of international finance.

1. International finance helps in calculating exchange rates of various currencies of nations and the relative worth of each and every nation in terms thereof.
2. It helps in comparing the inflation rates and getting an idea about investing in international debt securities.
3. It helps in ascertaining the economic status of the various countries and in judging the foreign market.
4. International Financial Reporting System (IFRS) facilitates comparison of financial statements made by various countries.
5. It helps in understanding the basics of international organisations and maintaining the balance among them.
6. International finance organisations such as IMF, World Bank etc. mediate and resolve financial disputes among member nations.

20.02 Foreign Direct Investment and Institutional Investors

Foreign Direct Investment occurs when an investor based on one's native country (the home country) acquires an asset or a company in another country (in host country) with the intention to manage the asset or the company. The investing company exercises control over decision-making in an enterprise located in a foreign country according to the level of equity shares held by it.

The foreign direct investments take the following forms

1. Establishment of a new enterprise in a foreign country.
2. Expansion of existing branch or subsidiary in a foreign country.
3. Acquisition of enterprise located in a foreign country.

Prior to 1999, FDI was permitted selectively on a case to case basis with a normal ceiling of 40% of total equity capital. However a higher percentage of equity was permitted in the case of high-tech import areas and export oriented units. After the Economic liberalisation, the ceiling was removed and 100% of foreign equities are permitted only in selected sectors.

Meaning

Foreign direct investment (FDI) is an investment made by a company or an individual in one country with business interests in another country, in the form of either establishing business operations or acquiring business assets in the other country, such as ownership or controlling interest in a foreign company.

Advantages of FDI

1. **Achieving Higher Growth in National Income** Developing countries get much needed capital through FDI to achieve higher rate of growth in national income.
2. **Help in Addressing BOP Crisis** FDI provides inflow of foreign exchange resources into a country. This helps the country to solve adverse balance of payment position.
3. **Faster Economic Development** FDI brings technology, management and marketing skills along with it. These are crucial for achieving faster economic development of developing countries.
4. **Generating Employment Opportunities** FDI generates a lot of employment opportunities in developing countries, especially in high skill areas.
5. **Encouraging Competition in Host Countries** Entry of FDI into developing country promotes healthy competition therein. This leads to enterprise in developing countries operating efficiently and effectively in the market. Consumers get a variety of products of good quality at market determined price which usually benefits the customers.

Disadvantages of FDI

1. Exploiting Natural Resources: The FDI Companies deplete natural resources like water, forest, mines etc. As a result such resources are not available for the usage of common man in the host country.

2. Heavy Outflow of capital Foreign companies are said to take away huge funds in the form of dividend, royalty fees etc. This causes a huge outflow of capital from the host country.

3. Not Transferring Technology Some foreign enterprises do not transfer the