Contents

CONSTITUTION OF INDIA

Part III (Articles 12 – 35)

(Subject to certain conditions, some exceptions and reasonable restrictions)

guarantees these

Fundamental Rights

Right to Equality
- before law and equal protection of laws;
- irrespective of religion, race, caste, sex or place of birth;
- of opportunity in public employment;
- by abolition of untouchability and titles.

Right to Freedom
- of expression, assembly, association, movement, residence and profession;
- of certain protections in respect of conviction for offences;
- of protection of life and personal liberty;
- of free and compulsory education for children between the age of six and fourteen years;
- of protection against arrest and detention in certain cases.

Right against Exploitation
- for prohibition of traffic in human beings and forced labour;
- for prohibition of employment of children in hazardous jobs.

Right to Freedom of Religion
- freedom of conscience and free profession, practice and propagation of religion;
- freedom to manage religious affairs;
- freedom as to payment of taxes for promotion of any particular religion;
- freedom as to attendance at religious instruction or religious worship in educational institutions wholly maintained by the State.

Cultural and Educational Rights
- for protection of interests of minorities to conserve their language, script and culture;
- for minorities to establish and administer educational institutions of their choice.

Right to Constitutional Remedies
- by issuance of directions or orders or writs by the Supreme Court and High Courts for enforcement of these Fundamental Rights.

PART I

Foundations of Business

Chapter 1

Business, Trade and Commerce

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

i. Appreciate the development of trade and commerce in historical past;

ii. Understand the role of indigenous banking system in trade and commerce;

iii. Explain the concept and objectives of business;

iv. Discuss types of industries;

v. Explain the activities relating to commerce;

vi. Describe the nature of business risks and their causes; and

vii. Discuss the basic factors to be considered while starting a business.

Imran, Manpreet, Joseph and Priyanka have been classmates in Class X. After their exams are over, they happen to meet at a common friend Ruchika's house. Just when they were sharing their experiences of examination days, Ruchika's father Raghuraj Chaudhary intervenes and asks about their well- being. He also enquires about their career plans. But none of them had a definite reply. Raghuraj who himself is a successful businessman tells them about business as a career opportunity. Joseph gets excited by the idea and says "yes, business is really good for making lots of money". Raghuraj tells them that 'there is a lot more to business than merely money'. Business activities lead to growth and development of any country, he added. He further tells them that the roots of business activities can be traced back to ancient times and how trading helps in the prosperity of the Indian subcontinent. Priyanka said that they have read about the Silk Route in their history textbooks. Raghuraj then gets busy with his day-to-day tasks. However, the four classmates begin raising questions. The conversation of the four classmates focused on how trading activities were conducted during ancient times. How far can the roots of trading activities be traced? Why was the Indian subcontinent referred to as '*Swaran Bharat and Swaran Dweep*' by the then travellers to India? What made Columbus and Vasco da Gama undertake journeys to locate India? They decided to meet the commerce teacher of their school to find out answers to many such questions about the development, nature and purpose of business.

1.1 Introduction

All human beings, wherever they may be, require different types of goods and services to satisfy their needs. The necessity of supplying goods and services has led to certain activities being undertaken by people to produce and sell what is needed by others. Business is a major economic activity in all modern societies concerned as it is concerned with the production and sale of goods and services required by people. The purpose behind most business activities is to earn money by meeting people's demands for goods and services. Business is central to our lives. Although our lives are influenced by many other institutions in modern society, such as schools, colleges, hospitals, political parties and religious bodies, business has a major influence on our daily lives. It, therefore, becomes important that we understand the concept, nature and purpose of business.

The chapter is divided into two sections. Section I deals with the history of trade and commerce in ancient India. Section II deals with the concept, nature and purpose of business.

SECTION I

History of Trade and Commerce

The economic and commercial evolution of any land depends upon its physical environment. This stands true for the Indian subcontinent as a whole which has Himalayas in the North bordered by water in the South. A network of roads merging into the Silk Route helped in establishing commercial and political contacts with adjoining foreign kingdoms and empires of Asia, in particular, and the world, in general. The maritime routes linked the east and the west by sea and were used for the trade of spices and known as 'spice route'. Due to the flow of wealth through these routes, the chief kingdoms, important trade centres and the industrial belt flourished, which in turn further facilitated the progress of domestic and international trade in ancient India.

Trade and commerce have played a vital role in making India to envolve as a major actor in the economic world in ancient times. Archaeological evidences have shown that trade and commerce was the mainstay of the economy of ancient India carried out by water and land. Commercial cities like Harappa and Mohenjodaro were founded in the third millennium B.C. The civilisation had established commercial connections with Mesopotamia and traded in gold, silver, copper, coloured gemstones, beads, pearls, sea shells, terracotta pots, etc. The period was marked by substantial commercial activities and urban development. Political economy and military security during ancient times united most of the Indian subcontinent and trade regulations were carefully planned. There were diverse types of coins and weighing practices which used to vary from place to place with the help of money changers and by resorting to certain commonly accepted weights and measures.

1.1 Indigenous Banking System

As economic life progressed, metals began to supplement other commodities as money because of its durability and divisibility. As money served as a medium of exchange, the introduction of metallic money and its use accelerated economic activities.

Documents such as *Hundi* and *Chitti* were in use for carrying out transactions in which money passed from hand to hand. *Hundi* as an instrument of exchange, which was prominent in the subcontinent. It involved a contract which — (i) warrant the payment of money, the promise or order which is unconditional (ii) capable of change through transfer by valid negotiation.

Indigenous banking system played a prominent role in lending money and financing domestic and foreign trade with currency and letter of credit. With the development of banking, people began to deposit precious metals with lending individuals functioning as

Hundi as practised by Indian Merchaant Communities		
Name of *Hundi*	**Broader Classification**	**Functions of *Hundi***
Dhani-jog	*Darshani*	Payable to any person—no liability over who received payment.
Sah-jog	*Darshani*	Payable to a specific person, someone 'respectable'. Liability over who received payment.
Firman-jog	*Darshani*	*Hundi* made payable to order.
Dekhan-har	*Darshani*	Payable to the presenter or bearer.
Dhani-jog	*Muddati*	Payable to any person—no liability over who received payment, but payment over a fixed term.
Firman-jog	*Muddati*	*Hundi* made payable to order following a fixed term.
Jokhmi	*Muddati*	Drawn against dispatched goods. If goods lost in transit, the drawer or holder bears the coasts, and the Drawee carries no liability.

bankers or *Seths*, and money became an instrument for supplying the manufacturers with a means of producing more goods.

Agriculture and the domestication of animals were important components of the economic life of ancient people. Due to the favourable climatic conditions they were able to raise two or sometimes three crops in a year. In addition to this, by resorting to weaving cotton, dyeing fabrics, making clay pots, utensils, and handicrafts, sculpting, cottage industries, masonry, manufacturing, transports (i.e., carts, boats and ships), etc., they were able to generate surpluses and savings for further investment.

Workshops (*Karkhana)* were prominent where skilled artisans worked and converted raw materials into finished goods which were high in demand. Family-based apprenticeship system was in practice and duly followed in acquiring trade-specific skills. The artisans, craftsmen and skilled labourers of different kinds learnt and developed skills and knowledge, which were passed on from one generation to another.

1.2.1 Rise of Intermediaries

Intermediaries played a prominent role in the promotion of trade. They provided considerable financial security to the manufacturers by assuming responsibility for the risks involved, especially in foreign trade. It comprised commission agents, brokers and distributors both for wholesale and retail goods. An expanding trade brought in huge amounts of silver bullion into Asia and a large share of that bullion gravitated towards India.

The institution of *Jagat Seths* also developed and exercised great influence during the Mughal period and the days of the East India Company. Bankers began to act as trustees and executors of endowments. Foreign trade was financed by loans. However, the rate of interest for longer voyages was kept high in view of the huge risk involved.

The emergence of credit transactions and availability of loans and advances enhanced commercial operations.The Indian subcontinent enjoyed the fruits of favourable balance of trade, where exports exceeded imports with large margins and the indigenous banking system benefitted the manufacturers, traders and merchants with additional capital funds for expansion and development. Commercial and Industrial banks later evolved to finance trade and commerce and agricultural banks to provide both short-and long-term loans to finance agriculturists.

1.3 Transport

Transport by land and water was popular in the ancient times. Trade was maintained by both land and sea. Roads as a means of communication had assumed key importance in the entire process of growth, particularly of the inland trade and for trade over land. The northern roadway route is believed to have stretched originally from Bengal to Taxila. There were also trade routes in the south spreading east and west. Trade routes were structurally wide and suitable for speed and safety.

Maritime trade was another important branch of global trade network. Malabar Coast, on which Muziris is situated, has a long history of international maritime trade going back to the era of the Roman Empire. Pepper was particularly valued in the Roman Empire and was known as 'Black Gold'. For centuries, it remained the reason for rivalry and conflict between various empires and trade powers to dominate the route for this trade. It was in the search for an alternate route to India for spices that led to the discovery of America by Columbus in the closing years of 15th century and also brought Vasco da Gama to the shores of Malabar in 1498.

Calicut was such a bustling emporium that it was even visited by Chinese ships to acquire items, like frankincense (essential oil) and myrrh (fragrant resin used in perfumes, medicines) from the Middle East, as well as, pepper, diamonds, pearls and cotton from India. On the Coromandel Coast, Pulicat was a major port in the 17th century. Textiles were the principal export from Pulicat to Southeast Asia.

1.4 Trading Communities Strengthened

In different parts of the country, different communities dominated trade. *Punjabi* and *Multani* merchants handled business in the northern region, while the *Bhats* managed the trade in the states of Gujarat and Rajasthan. In western India, these groups were called *Mahajan*, Chatt is were important traders from the South. In urban centres, such as Ahmedabad the Mahajan community collectively represented by their chief called *nagarseth.* Other urban groups included professional classes, such as *hakim* and *vaid* (physician), *wakil* (Lawyer), *pundit or mulla* (teachers), painters, musicians, calligraphers, etc.

1.4.1 Merchant Corporations

The merchant community also derived power and prestige from guilds, which were autonomous corporations formed to protect the interests of the traders. These corporations, organised on formal basis, framed their own rules of membership and professional code of conduct, which even kings were supposed to accept and respect. Trade and industry taxes were also a major source of revenue. Traders had to pay octroi duties that were levied on most of the imported articles at varying rates. They were paid either in cash or in kind.

Customs duties varied according to the commodities. Tariffs varied from province to province. The ferry tax was another source of income generation. It had to be paid for passengers, goods, cattle and carts. The right to receive the labour tax was usually transferred to the local bodies.

The guild chief dealt directly with the king or tax collectors and settled the market toll on behalf of its fellow merchants at a fixed sum of money. The guild merchants also acted as custodians of religious interests. They undertook the task of building temples and made donations by levying a corporate tax on their members. The commercial activity, thus, enabled big merchants to gain power in the society.

1.4.2 Major Trade Centres

There were all kinds of towns—port towns, manufacturing towns, mercantile towns, the sacred centres, and pilgrimage towns. Their existence is an index of prosperity of merchant communities and professional classes.

The following were the leading trade centres in ancient India:

***1. Pataliputra*:** Known as Patna today. It was not only a commercial town, but also a major centre for export of stones.

***2. Peshawar*:** It was an important exporting centre for wool and for the import of horses. It had a huge share in commercial transactions between India, China and Rome in the first century A.D.

***3. Taxila*:** It served as a major centre on the important land route between India and Central Asia. It was also a city of financial and commercial banks. The city occupied an important place as a Buddhist centre of learning. The famous Taxila University flourished here.

4. Indraprastha: It was the commercial junction on the royal road where most routes leading to the east, west, south and north converged.

5. Mathura: It was an emporium of trade and people here subsisted on commerce. Many routes from South India touched Mathura and Broach.

6. Varanasi: It was well placed as it lay both on the Gangetic route and on the highway that linked North with the East. It grew as a major centre of textile industry and became famous for beautiful gold silk cloth and sandalwood workmanship. It had links with Taxila and Bharuch.

7. Mithila: The traders of Mithila crossed the seas by boats, through the Bay of Bengal to the South China Sea, and traded at ports on the islands of Java, Sumatra and Borneo. Mithila established trading colonies in South China, especially in Yunnan.

8. Ujjain: Agate, carnelian, muslin and mallow cloth were exported from Ujjain to different centres. It also had trade relations through the land route with Taxila and Peshawar.

9. Surat: It was the emporium of western trade during the Mughal period. Textiles of Surat were famous for their gold borders (zari). It is noteworthy that Surat *hundi* was honoured in far off markets of Egypt and Iran.

10. Kanchi: Today known as Kanchipuram, it was here that the Chinese used to come in foreign ships to purchase pearls, glass and rare stones and in return they sold gold and silk.

11. Madura: It was the capital of the Pandayas who controlled the pearl fisheries of the Gulf of Mannar. It attracted foreign merchants, particularly Romans, for carrying out overseas trade.

12. Broach: It was the greatest seat of commerce in Western India. It was situated on the banks of river Narmada and was linked with all important marts by roadways.

13. Kaveripatta: Also known as Kaveripatnam, it was scientific in its construction as a city and provided loading, unloading and strong facilities of merchandise. Foreign traders had their headquarters in this city. It was a convenient place for trade with Malaysia, Indonesia, China and the Far East. It was the centre of trade for perfumes, cosmetics, scents, silk, wool, cotton, corals, pearls, gold and precious stones; and also for ship building.

14. Tamralipti: It was one of the greatest ports connected both by sea and land with the West and the Far East. It was linked by road to Banaras and Taxila.

1.4.3 Major Exports and Imports

Exports consisted of spices, wheat, sugar, indigo, opium, sesame oil, cotton, parrot, live animals and animal products—hides, skin, furs, horns, tortoise shells, pearls, sapphires, quartz, crystal, lapis, lazuli, granites, turquoise and copper etc.

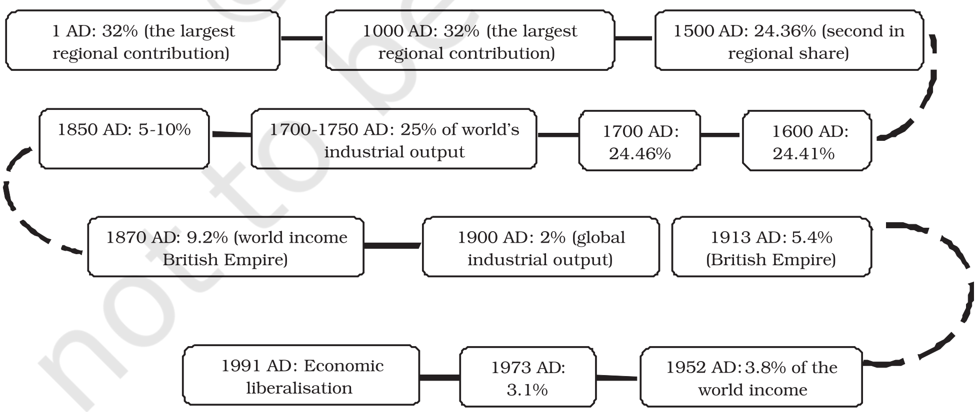
Imports included horses, animal products, Chinese silk, flax and linen, wine, gold, silver, tin, copper, lead, rubies, coral, glass, amber, etc.

1.5 Position of Indian Subcontinent in World Economy (1 AD up to 1991)

Between the 1st and the 7th centuries CE, India is estimated to have the largest economy of the ancient and medieval world, controlling about one-third and one-fourth of the world's wealth (timeline). The country was often referred to as '*Swaranbhumi*' and '*Swarndweep*' in the writings of many travellers, such as Megasthenes, Faxian (Fa Hien), Xuanzang (Huen Tsang), Al Beruni (11th century), Ibn Batuta (11th century), Frenchman Francois (17th century) and others. They repeatedly refer to the prosperity of the country.

The pre-colonial period in Indian history was an age of prosperity for Indian economy and made the Europeans embark great voyage of discovery. Initially, they came to plunder but soon realised the rewards of trade in exchange of gold and silver. Despite the growing commercial sector, it is evident that the 18th century India was far behind Western Europe in technology, innovation and ideas. With the increasing control of the East India Company causing lack of freedom and no occurrence of agricultural and scientific revolution, limited reach of education to the masses, population growth and preference to machines over manual skills made India a country which was prosperous but with people who were poor.

The British empire began to take roots in India in the mid– 18th century. The East India Company used revenues generated by the provinces under its rule for purchasing Indian raw materials, spices and goods. Hence, the continuous inflow



Source: *Angus Maddison (2001 and 2003), The World Economy: A Millennial Perspective, OECD, Paris; Angus Maddison, The World Economy, Historical Statistics* of bullion that used to come on account of foreign trade stopped. This changed the condition of the Indian economy from being an exporter of processed goods to the exporter of raw materials and buyer of manufactured goods.

1.5.1 India begins to Reindustrialise

After Independence, the process of rebuilding the economy started and India went for centralised planning. The First Five Year Plan was implemented in 1952. Due importance was given to the establishment of modern industries, modern technological and scientific institutes, space and nuclear programmes. Despite these efforts, the Indian economy could not develop at a rapid pace. Lack of capital formation, rise in population, huge expenditure on defence and inadequate infrastructure were the major reasons. As a result, India relied heavily on borrowings from foreign sources and finally, agreed to economic liberalisation in 1991.

The Indian economy is one of the fastest growing economies in the world today and a preferred FDI destination. Rising incomes, savings, investment opportunities, increased domestic consumption and younger population ensures growth for decades to come. The high growth sectors have been identified, which are likely to grow at a rapid pace world over and the recent initiatives of the Government of India such as 'Make in India', Skill India', 'Digital India' and roll out of the Foreign Trade Policy (FTP 2015-20) is expected to help the economy in terms of exports and imports and trade balance.

Indian entrepreneurs began to set up their own modern textile mills after 1850 and, gradually, began to recapture the domestic market. In 1896, Indian mills supplied 8% of the total cloth consumed in India, 20% in 1913, 62% in 1936 and 76% in 1945. Thus, during 1913-1938 India's manufacturing output grew 5.6% during per year, which was above the world average of 3.3%. The British government, finally, provided tariff protection from 1920s, which helped industrialists to expand and diversify.

By the time of Independence in 1947, Indian entrepreneurs were strong enough and in a position to buy the businesses of departing British. Industry's share in India's GDP had doubled from 3.18% in 1913 to 7.5% in 1947 and the share of manufacturers in exports rose from 22.4% to 30% for the years 1913 and 1947, respectively.

Source: *B.R. Tomlison, The Economy of Modern India 1870-1970, The New Cambridge History of India, Volume 3.3. Cambridge University Press, 1996.*

SECTION II

NATURE AND CONCEPT OF BUSINESS

1.6 CONCEPT OF BUSINESS

The term business is derived from the word 'busy'. Thus, business means being busy. However, in a specific sense, business refers to an occupation in which people regularly engage in activities related to purchase, production and/or sale of goods and services with a view to earning profits. The activity may consist of production or purchase of goods for sale, or exchange of goods or supply of services to satisfy the needs of other people.

In every society, people undertake various activities to satisfy their needs. These activities may be broadly classified into two groups — economic and non-economic. Economic activities are those by which we can earn our livelihood, whereas, non-economic activities are performed out of love, sympathy, sentiment, patriotism, etc. For example, a worker working in a factory, a doctor operating in his clinic, a manager working in an office and a teacher teaching in a school are doing so to earn their livelihoods and are, therefore, engaged in an economic activity. On the other hand, a housewife cooking food for her family, or a boy helping an old man cross the road are performing non-economic activities since they are doing so out of love or sympathy. Economic activities may be further divided into three categories, namely business, profession and employment. Business may be defined as an economic activity involving the production and sale of goods and services undertaken with a motive of earning profit by satisfying human needs in society.

Try it yourself:

State whether each of the following is an economic activity:

1. Farmer growing rice for her own consumption. ☐
2. A factory owner producing school bags for sale in the market. ☐
3. Person begging at a busy traffic intersection. ☐
4. Services of a domestic help doing household chores at an employer's house. ☐
5. Services of a housewife doing household chores at home. ☐

1.6.1 Characteristics of Business Activities

In order to appreciate how business activity is different from other activities in society, the nature of business or its fundamental character must be explained in terms of its distinguishing characteristics, which are as follows:

(i) An economic activity: Business is considered to be an economic activity because it is undertaken with the objective of earning money or livelihood and not out of love, affection, sympathy or any other emotion. It may be mentioned here that this activity can be undertaken either on small and individual level, e.g. (purchase and sale by a shopkeeper) or on large scale in a more formal and organised level (purchase and sale by a cooperative society or company).

(ii) Production or procurement of goods and services: Before goods are offered to people for consumption, these must be either produced or procured by business enterprises. Thus, every business enterprise either manufactures the goods it deals in or acquires them from producers, to be further sold to consumers or users. Goods may consist of consumable items of daily use, such as sugar, ghee, pen, notebook, etc., or capital goods, like machinery, furniture, etc., Services may include facilities offered to consumers, business firms and organisations in the form of transportation, banking, electricity, etc.

(iii) Sale or exchange of goods and services: Directly or indirectly, business involves transfer or exchange of goods and services for value. If goods are produced not for the purpose of sale but for personal consumption, it cannot be called a business activity. Cooking food at home for the family is not business, but cooking food and selling it to others in a restaurant is business. Thus, one essential characteristic of business is that there should be sale or exchange of goods or services between the seller and the buyer.

(iv) Dealings in goods and services on a regular basis: Business involves dealings in goods or services on a regular basis. One single transaction of sale or purchase, therefore, does not constitute business. Thus, for example, if a person sells his/her domestic radio set even at a profit, it will not be considered a business activity. But if he/she sells radio sets regularly either through a shop or from his/her residence, it will be regarded as a business activity.

(v) Profit earning: One of the main purpose of business is to earn income by way of profit. No business can survive for long without profit. That is why, businessmen make all possible efforts to maximise profits, by increasing the volume of sales or reducing costs.

(vi) Uncertainty of return: Uncertainty of return refers to the lack of knowledge relating to the amount of money that the business is going to earn in a given period. Every business invests money (capital) to run its activities with the objective of earning profit. But it is not certain as to what amount of profit will be earned. Also, there is always a possibility of losses being incurred, dispite the best efforts put into the business.

(vii) Element of risk: Risk is the uncertainty associated with an exposure to loss. It is caused by some unfavourable or undesirable event. Risks are related with factors, like changes in consumer taste and fashion, changes in method of production, strike or lockout at workplace, increased competition in market, fire, theft, accidents, natural calamities, etc. No business can altogether do away with risks.

1.6.2 Comparison of Business, Profession and Employment

As has been mentioned earlier, economic activities may be divided into three major categories viz., Business, Profession and Employment. The difference between these three terms is given in the following table.

1.7 Classification of Business Activities

Various business activities may be classified into two broad categories — industry and commerce. Industry is concerned with the production or processing of goods and materials. Commerce includes all those activities, which are necessary for facilitating the exchange of goods and services. On the basis of these two categories, we may classify business firms into industrial and commercial enterprises. Let us examine in detail the activities relating to business.

Business Functions at Enterprise Level

Business includes a wide variety of functions performed by different kinds of organisations called business enterprises or firms. Financing, production, marketing and human resource management are the four major functions which are performed by business enterprises. Financing is concerned with mobilising and utilising funds for running a business enterprise. Production involves the conversion of raw materials into finished products or generation of services. Marketing refers to all those activities which facilitate exchange of goods and services from producers to the people who need them at a place they want, at a time they require and at a price they are prepared to pay. Human resource management aims at ensuring the availability of working people who have necessary skills to perform various tasks in enterprises.

Basic	Business	Profession	Employment
1. Mode of establishment	Entrepreneur's decision and other legal formalities, if necessary	Membership of a professional body and certificate of practice	Appointment letter and service agreement
2. Nature of work	Provision of goods and services to the public	Rendering of personalised, expert services	Performing work as per service contract or rules of service
3. Qualification	No minimum qualification is necessary	Qualifications, expertise and training in specific field as prescribed by the professional body is a must	Qualification and training as prescribed by the employer
4. Reward or return	Profit earned	Professional fee	Salary or wages
5. Capital investment	Capital investment required as per size and nature of business	Limited capital needed for establishment	No capital required
6. Risk	Profits are uncertain and irregular; risk is present	Fee is generally regular and certain; some risk	Fixed and regular pay; no or little risk
7. Transfer of interest	Transfer possible with some formalities	Not possible	Not possible
8. Code of conduct	No code of conduct is prescribed	Professional code of conduct is to be followed	Norms of behaviour laid down by the employer are to be followed
9. Example	Shop, factory	Legal, medical profession, chartered accountancy	Jobs in banks, insurance companies, government departments

1.7.1 Industry

Industry refers to economic activities, which are connected with conversion of resources into useful goods. 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 raising of animals. The term industry is also used to mean groups 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. Industries may be divided into three broad categories namely primary, secondary and tertiary.

(i) **Primary industries:** These include all those activities which are concerned with the extraction and production of natural resources and reproduction and development of living organisms, plants, etc. These are divided as follows.

(a) **Extractive industries:** These industries extract or draw 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, lumbering, hunting and fishing operations.

(b) **Genetic industries:** These industries are engaged in breeding plants and animals for their use in further reproduction. Seeds and nursery companies are typical examples of genetic industries. In additional, activities of cattle breeding farms, poultry farms, and fish hatchery come under genetic industries.

(ii) **Secondary industries:** These are concerned with using materials, which have already been extracted at the primary state. These industries process such materials to produce goods for final consumption or for further processing by other industrial units. For example, mining of 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:

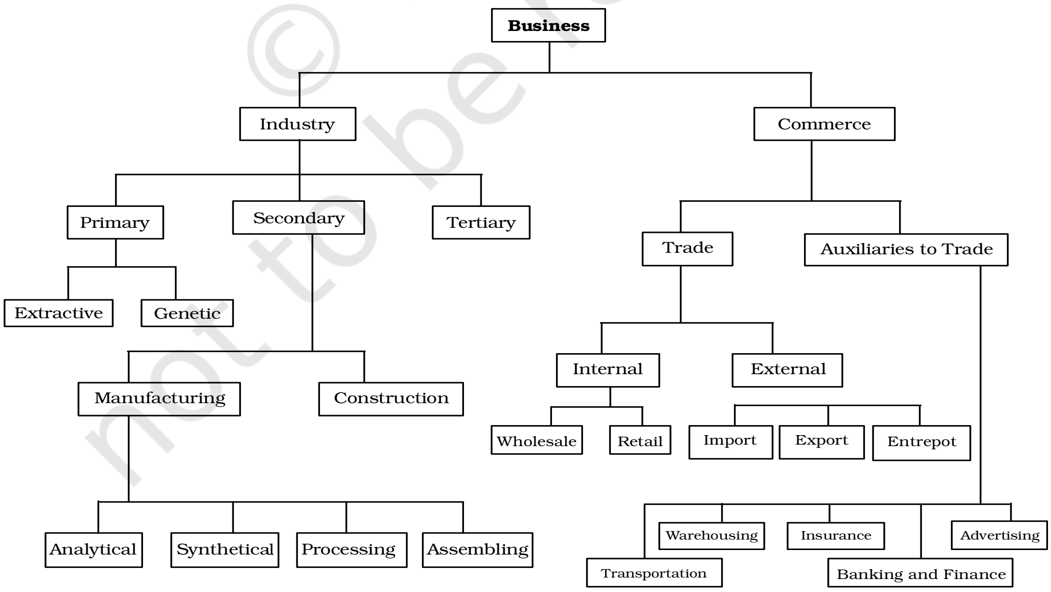
(a) **Manufacturing industries:** These industries are engaged in producing goods through processing of raw materials and, thus, creating form utilities. They bring out diverse finished products, that we consume, or use through the conversion of raw materials or partly finished materials in their manufacturing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

- *Analytical industry* which analyses and separates different elements from the same materials, as in the case of oil refinery.
- *Synthetical industry* which combines various ingredients into a new product, as in the case of cement.
- *Processing industry* which involves successive stages for manfucturing finished products, as in the case of sugar and paper.
- *Assembling industry* which assembles different component parts to make a new product, as in the case of television, car, computer, etc.

(b) Construction industries: These industries are involved in the construction of buildings, dams, bridges, roads as well as tunnels and canals. Engineering and architectural skills are an important part in construction industries.

(iii) Tertiary industries: These are concerned with providing support services to primary and secondary industries as well as activities relating to trade. These industries provide service facilities. As business activities, these may be considered part of commerce because as auxiliaries to trade these activities assist trade. Included in this category are transport, banking, insurance, warehousing, communication, packaging and advertising.

Chart Showing Business Activities



1.7.2 Commerce

Commerce includes two types of activities, viz., (i) trade and (ii) auxiliaries to trade. Buying and selling of goods is termed as trade. But there are a lot of activities that are required to facilitate the purchase and sale of goods. These are called services or auxiliaries to trade and include transport, banking, insurance, communication, advertisement, packaging and warehousing. Commerce, therefore, includes both, buying and selling of goods i.e., trade, as well as, auxiliaries, such as transport, banking, etc.

Commerce provides the necessary link between producers and consumers. It embraces all those activities, which are necessary for maintaining a free flow of goods and services. Thus, all activities involving the removal of hindrances in the process of exchange are included in commerce. The hindrances may be in respect of persons, place, time, risk, finance, etc. The hindrance of persons is removed by trade, thereby, making goods available to consumers from the possession or ownership producers. Transport removes the hindrances of place by moving goods from the place of production to the markets for sale. Storage and warehousing activities remove the hindrance of time by facilitating holding of stocks of goods to be sold as and when required. Goods held in stock, as well as, goods in course of transport are subject to a risk of loss or damage due to theft, fire, accidents, etc. Protection against these risks is provided by insurance of goods. Capital required to undertake the above activities is provided by banking and financing institutions. Advertising makes it possible for producers and traders to inform consumers about the goods and services available in the market. Hence, commerce is said to consist of activities of removing the hindrances of persons, place, time, risk, finance and information in the process of exchange of goods and services.

'Make in India' is an initiative launched by the Government of India on 25 September 2014, to encourage national, as well as multinational companies to manufacture their products in India. The major objectives behind the 'Make in India' initiative are job creation and skill enhancement in 25 sectors of the economy, which are as follows.

Trade may be classified into two broad categories – internal and external. Internal, domestic or home trade is concerned with the buying and selling of goods and services within the geographical boundaries of a country. This may further be divided into wholesale and retail trade. When goods are purchased and sold in comparatively smaller quantities, for final consumption it is referred to as retail trade. External or foreign trade consists of the exchange of goods and services between persons or organisations operating in two or more countries. If goods are purchased from another country, it is called import trade. If they are sold to other countries, it is known as export trade. When goods are imported for export to other countries, it is known as entrepot trade.

1. Automobile	2. Automobile Components	3. Aviation
4. Biotechnology	5. Chemicals	6. Construction
7. Defence Manufacturing	8. Electrical Machinery	9. Electronic Systems
10. Food Processing	11. Information Technology and Business Process Management	12. Leather
13. Media and Entertainment	14. Mining	15. Oil and Gas
16. Pharmaceuticals	17. Port and Shipping	18. Railways
19. Renewable Energy	20. Roads and Highways	21. Space and Astronomy
22. Textiles and Garments	23. Thermal power	24. Tourism and Hospitality
25. Wellness		

1.7.3 Trade

Trade is an essential part of commerce. It refers to sale, transfer or exchange of goods. It helps in making the goods produced available to the consumers or users. These days goods are produced on a large scale and it is difficult for producers to themselves reach out to individual buyers for selling their products. Businessmen are engaged in trading activities to make the goods available to consumers in different markets. In the absence of trade, it would not be possible to undertake production activities on a large scale.

1.7.4 Auxiliaries to Trade

Activities which are meant for assisting trade are known as auxiliaries to trade. These activities are generally referred to as services because these are in the nature of facilitating the activities relating to industry and trade. Transport, banking, insurance, warehousing, and advertising are regarded as auxiliaries to trade, i.e., activities playing a supportive role. In fact, these activities support not only trade, but also industry and, hence, the entire business activity. Auxiliaries are an integral part of commerce in particular and business activity in general. These activities help in removing various hindrances which arise in connection with the production and distribution of goods. Transport facilitates movement of goods from one place to another. Banking provides financial assistance to the manufacturer and trader. Insurance covers various kinds of business risks. Warehousing creates time utility by way of storage facilities. Advertising provides information to the consumers. In other words, these activities facilitate movement, storage, financing, risk coverage and sales promotion of goods. Auxiliaries to trade are briefly discussed below:

(i) Transport and Communication: Production of goods generally takes place in particular locations. For instance, tea is mainly produced in Assam; cotton in Gujarat and Maharashtra; jute in West Bengal and Odisha; sugar in U.P., Bihar and Maharashtra and so on. But these goods are required for consumption in different parts of the country. The obstacle of place is removed by transport through road, rail or coastal shipping. Transport facilitates movement of raw material, to the place of production and the finished products from factories to the place of consumption. Along with transport facility, there is also a need for communication facilities so that producers, traders and consumers may exchange information with one another. Thus, postal services and telephone facilities may also be regarded as auxiliaries to business activities.

(ii) Banking and Finance: Business activities cannot be undertaken unless funds are available for acquiring assets, purchasing raw materials and meeting other expenses. Necessary funds can be obtained by businessmen from a bank. Thus, banking helps business activities to overcome the problem of finance. Commercial banks, generally lend money by providing overdraft and cash credit facilities, loans and advances. Banks also undertake collection of cheques, remittance of funds to different places, and discounting of bills on behalf of traders. In foreign trade, commercial banks help exporters in collecting money from importers. Commercial banks also help promoters of companies to raise capital from the public.

(iii) Insurance: Business involves various types of risks. Factory building, machinery, furniture, etc., must be protected against fire, theft and other risks. Material and goods help 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.

(iv) 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 the storage of goods to prevent loss or damage. Warehousing helps business firms to overcome the problem of storage and facilitates the availability of goods when needed. Prices are, thereby, maintained at a reasonable level through continuous supply of goods.

(v) Advertising: Advertising is one of the most important methods of promoting the sale of products, particularly, consumer goods, like electronic and automobile goods, soaps, detergents, etc. Most of these goods are manufactured and supplied in the market by numerous firms — big or small. It is practically impossible for producers and traders to contact each and every customer. Thus, for promoting sales, information about the goods and services available, their features, price, etc., must reach potential buyers. Also, there is a need to persuade potential buyers about the uses, quality, prices, competitive information about the goods and services etc. Advertising helps in providing information about available goods and services and inducing customers to buy particular items.

1.8 Objectives of Business

An objective is the starting point of business. Every business is directed to the achievement of certain objectives. Objectives refer to all that the business people want to get in return for what they do. It is generally believed that business activity is carried out only for profit. Business persons themselves proclaim that their primary objective is produce or distribute goods or services for profit. Every business is said to be an attempt on the part of business people to get more than what has been spent or invested, or in other words, to earn profit which is the excess of revenue over cost. However, it is being increasingly realised nowadays that business enterprises are part of the society and need to fulfill several objectives, including social responsibility, to survive and prosper in the long run. Profit is found to be a leading objective but not the only one.

Although earning profit cannot be the only objective of business, its importance cannot be ignored. Every business is an attempt to reap more than what has been invested, and profit is the excess of revenue over cost. Profit may be regarded as an essential objective of business for various reasons: (i) it is a source of income for business persons, (ii) it can be a source of finance for meeting expansion requirements of business, (iii) it indicates the efficient working of business, (iv) it can be taken as the society's approval of the utility of business, and (v) it builds the reputation of a business enterprise.

However, too much emphasis on profit to the exclusion of other objectives can be dangerous for good business.

Obsessed with profit, business managers may neglect all other responsibilities towards customers, employees, investors and society at large. They may even be inclined to exploit various sections of society to earn immediate profit. This may result in the non-cooperation or even opposition from the affected people against the malpractices of business enterprises. The enterprises might lose business and may be unable to earn profit. That is the reason why there is hardly any sizable business enterprise who only objective is maximisation of profit.

1.9 Multiple Objectives of Business

Objectives are needed in every area that influences the survival and prosperity of business. Since a business has to balance a number of needs and goals, it requires multiple objectives. It cannot follow only one objective and expect to achieve excellence. Objectives have to be specific in every area and sphere of business. For example, sales targets have to be set, the amount of capital to be raised has to be estimated and the target number of units to be produced needs to be defined. The objectives define in concrete terms what the business is going to do. Objectives also enable the business to analyse their own performance and take steps as necessary to improve their performance in future.

Objectives are needed in every area where performance and results affect the survival and prosperity of business. Some of these areas are described as follows.

(i) **Market standing:** Market standing refers to the position of an enterprise in relation to its competitors. A business enterprise must aim at standing on stronger footing in terms of offering competitive products to its customers and serving them to their satisfaction.

(ii) **Innovation:** Innovation is the introduction of new ideas or methods in the way something is done or made. There are two kinds of innovation in every business i.e., (i) innovation in product or services; and (ii) innovation in various skills and activities needed to supply products and services. No business enterprise can flourish in a competitive world without innovation. Therefore, innovation becomes an important objective.

(iii) **Productivity:** Productivity is ascertained by comparing the value of output with the value of inputs. It is used as a measure of efficiency. In order to ensure continuous survival and progress, every enterprise must aim at greater productivity through the best use of available resources.

(iv) **Physical and financial resources:** Any business requires physical resources, like plants, machines, offices, etc., and financial resources, i.e., funds to be able to produce and supply goods and services to its customers. The business enterprise must aim at acquiring these resources according to their requirements and use them efficiently.

(v) **Earning profits:** One of the objectives of business is to earn profits on the capital employed. Profitability refers to profit in relation to capital investment. Every business must earn a reasonable profit which is so important for its survival and growth.

(vi) **Manager performance and development:** Business enterprises need managers to conduct and coordinate business activity. Various programmes for motivating managers need to be implemented. Manager performance and development, therefore, is an important objective. The enterprises must actively work for this purpose.

(vii) **Worker performance and attitude:** Workers' performance and attitudes determine their contribution towards productivity and profitability of any enterprise. Therefore, every enterprise must aim at improving its workers' performance. It should also try to ensure a positive attitude on the part of workers.

(viii) **Social responsibility:** Social responsibility refers to the obligation of business firms to contribute resources for solving social problems and work in a socially desirable manner.

Thus, a business enterprise must have multiple objectives to satisfy different individuals and groups. This is essential for its own survival and prosperity.

1.10 Business Risks

The term 'business risks' refers to the possibility of inadequate profits or even losses due to uncertainties or unexpected events. For example, demand for a particular product may decline due to change in tastes and preferences of consumers or due to increased competition from other producers. Lower demand results in long sales and profits. In another situation, the shortage of raw materials in the market may shoot up its price. The firm using these raw materials will have to pay more for buying them. As a result, cost of production may increase which, in turn, may reduce profits.

Business enterprises constantly face two types of risk : speculative and pure. Speculative risks involve both the possibility of gain, as well as, the possibility of loss. Speculative risks arise due to changes in market conditions, including fluctuations in demand and supply, changes in prices or changes in fashion and tastes of customers. Favourable market conditions are likely to result in gains, whereas, unfavourable ones may result in losses. Pure risks involve only the possibility of loss or no loss. The chance of fire, theft or strike are examples of pure risks. Their occurrence may result in loss, whereas, non-occurrence may explain absence of loss, instead of gain.

1.10.1 Nature of Business Risks

Nature of 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 future. Natural calamities, change in demand and prices, changes in government policies and prices, improvement in technology, etc., are some of the examples of uncertainty which create risks for business because the outcomes of these future events are not known.

(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 minimised, 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 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.

1.10.2 Cause 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. 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 these type of causes as they result in higher unexpected cost of operation or 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.

Methods of Dealing with Risks

Although no business enterprise can escape the presence of risk, there are many methods a business enterprise can use to deal with risk situations. For instance, the enterprise may (a) decide not to enter into too risky transaction: (b) take preventive measures, like firefighting devices, to reduce risk; (c) take insurance policy to transfer risk to insurance company; (d) assume risk by making provisions in the current earnings as is the case of provision for bad and doubtful debts; or (e) share risks with other enterprises as manufacturers and wholesalers may do by agreeing to share losses which may be caused by falling prices.

1.11 Starting a Business — Basic Factors

Starting a business enterprise is similar to any other human effort in which resources are employed to achieve certain objectives. Successful results in business depend largely upon the ability of the entrepreneurs or the starters of a new business to anticipate problems and solve them with minimum cost. This is especially true of the modern business world where competition is very tough and risks are high. Some of the problems, which business firms encounter, are of basic nature. For example, to start a factory, plans must be made about the location of the business, the possible number of customers, the kind of equipment required and the amount of money needed to procure them, the shop layout, purchasing and financing needs, and hiring of workers for its effective implementation. These problems become more complex in a big business. However, some of the basic factors, which must be considered by anybody who is to start the business are as follows.

(i) Selection of line business: The first thing to be decided by an entrepreneur is the nature and type of business to be undertaken. He/she will obviously like to enter that branch of industry and commerce, which has the possibility of greater amount of profits. The decision will be influenced by the customer requirements in the market and also the kind of technical knowledge and interest the entrepreneur has for producing a particular product.

(ii) Size of the firm: Size of the firm or scale of its operation is another important decision to be taken at the start of the business. Some factors favour a large size, whereas, others tend to restrict the scale of operation. If the entrepreneur is confident that the demand for the proposed product is likely to be good over time and he/she can arrange the necessary capital for business, he/she will start the operation at a large scale. If the market conditions are uncertain and risks are high, a small size business would be better choice.

(iii) Choice of form of ownership: With respect to ownership, the business organisation may take the form of a sale proprietorship, partnership, or a joint stock company. Each form has its own merits and demerits. The choice of the suitable form of ownership will depend on such factors as the line of business, capital requirements, liability of owners, division of profit, legal formalities, continuity of business, transferability of interest and so on.

(iv) Location of business enterprise: An important factor to be considered at the start of the business is the place where the enterprise will be located. Any mistake in this regard can result in high cost of production, inconvenience in getting, right kind of production inputs or serving the customers in the best possible way. Availability of raw materials and labour; power supply and services, like banking, transportation, communication, warehousing, etc., are important factors while making a choice of location.

(v) Financing the proposition: Financing is concerned with providing the necessary capital for starting, as well as, for continuing the proposed business. Capital is required for investment in fixed assets, like land, building, machinery and equipment and in current assets, like raw materials, books, debts, stock of finished goods, etc. Capital is also required for meeting day-to-day expenses. Proper financial planning must be done to determine (a) the requirement of capital, (b) source from where the capital will be raised and (c) the best ways of utilising the capital in the firm.

(vi) Physical facilities: Availability of physical facilities, including machines and equipment, building and supportive services is an important factor to be considered at the start of the business. The decision relating to this factor will depend on the nature and size of business, availability of funds and the process of production.

(vii) Plant layout: Once the requirement of physical facilities has been determined, the entrepreneur should draw a layout plan showing the arrangement of these facilities. Layout means the physical arrangement of machines and equipment needed to manufacture a product.

(viii) Competent and committed worked force: Every enterprise needs competent and committed workforce to perform various activities so that physical and financial resources are converted into desired outputs. Since no individual entrepreneur can do everything himself, he/she must identify the requirement of skilled and unskilled workers and managerial staff. Plans should also be made about how the employees will be trained and motivated to give their best performance.

(ix) Tax planning: Tax planning has become necessary these days because there are a number of tax laws in the country and they influence almost every aspect of the functioning of modern business. The founder of the business has to consider in advance the tax liability under various tax laws and its impact on business decisions.

(x) Launching the enterprise: After the decisions relating to the above mentioned factors have been taken, the entrepreneur can go ahead with actual launching of the enterprise which would mean mobilising various resources, fulfilling necessary legal formalities, starting the production process and initiating the sales promotion campaign.

EXERCISES

Short Answer Questions

1. List any five major commercial cities of ancient India?
2. What is *Hundi*?
3. List the major exports and imports in ancient India.
4. What were the different types of *Hundi* in use by traders in ancient times?
5. What do you understand by maritime trade?
6. State the different types of economic activities.
7. Why is business considered as economic activity?
8. State the meaning of business.
9. How would you classify business activities?
10. What are the various types of industries?
11. Explain any two business activities which are auxiliaries to trade.
12. What is the role of profit in business?
13. What is business risk? What is its nature?

Long Answer Questions

1. Discuss the development of indigenous banking system in Indian subcontinent.
2. Define business. Describe its important characteristics.
3. Compare business with profession and employment.
4. Define Industry. Explain various types of industries giving examples.
5. Describe the activities relating to commerce.
6. Explain any five objectives of business.
7. Explain the concept of business risk and its causes.
8. What factors are to be considered while starting a business? Explain.

Projects/Assignments

1. Visit any business unit in your locality. Interact with the owner to find out the steps in starting the business. Prepare a project report of your visit.
2. Prepare a project report on the development of Trade and Commerce between 1st and 17th AD.
3. Collect information on any five sectors of the economy that *Make in India* focuses on. Find out the amount of investment in these sectors in the past two years. What were the possible reasons that led to an interest of investors in these sectors? Present your report in the following format:

Sector	Investment in Year I	Investment in Year II	Possible reasons for the change

CHAPTER 2

FORMS OF BUSINESS ORGANISATION

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- identify different forms of business organisation;
- explain features, merits and limitations of different forms of business organisations;
- distinguish between various forms of organisations; and
- discuss the factors determining choice of an appropriate form of business organisation.

Neha, a bright final year student was waiting for her results to be declared. While at home she decided to put her free time to use. Having an aptitude for painting, she tried her hand at decorating clay pots and bowls with designs. She was excited at the praise showered on her by her friends and acquaintances on her work. She even managed to sell a few pieces of unique hand pottery from her home to people living in and around her colony. Operating from home, she was able to save on rental payments. She gained a lot of popularity by word of mouth publicity as a sole proprietor. She further perfected her skills of painting pottery and created new motifs and designs. All this generated great interest among her customers and provided a boost to the demand for her products. By the end of summer, she found that she had been able to make a profit of Rs. 2500 from her paltry investment in colours, pottery and drawing sheets. She felt motivated to take up this work as a career. She has, therefore, decided to set up her own artwork business. She can continue running the business on her own as a sole proprietor, but she needs more money for doing business on a larger scale. Her father has suggested that she should form a partnership with her cousin to meet the need for additional funds and for sharing the responsibilities and risks. Side by side, he is of the opinion that it is possible that the business might grow further and may require the formation of a company. She is in a fix as to what form of business organisation she should go in for?

2.1 Introduction

If one is planning to start a business or is interested in expanding an existing one, an important decision relates to the choice of the form of organisation. The most appropriate form is determined by weighing the advantages and disadvantages of each type of organisation against one's own requirements.

Various forms of business organisations from which one can choose the right one include:

(a) Sole proprietorship,

(b) Joint Hindu family business,

(c) Partnership,

(d) Cooperative societies, and

(e) Joint stock company.

Let us start our discussion with sole proprietorship — the simplest form of business organisation, and then move on to analysing more complex forms of organisations.

2.2 Sole Proprietorship

Do you often go in the evenings to buy registers, pens, chart papers, etc., from a small neighbourhood stationery store? Well, in all probability in the course of your transactions, you have interacted with a sole proprietor.

Sole proprietorship is a popular form of business organisation and is the most suitable form for small businesses, especially in their initial years of operation. Sole proprietorship refers to a form of business organisation which is owned, managed and controlled by an individual who is the recipient of all profits and bearer of all risks. This is evident from the term itself. The word "sole" implies "only", and "proprietor" refers to "owner". Hence, a sole proprietor is the one who is the *only owner* of a business.

This form of business is particularly common in areas of personalised services such as beauty parlours, hair saloons and small scale activities like running a retail shop in a locality.

> 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*
>
> The individual proprietorship is the form of business organisation at the head of which stands an individual as one who is responsible, who directs its operations and who alone runs the risk of failure.
>
> *L.H. Haney*

Features

Salient characteristics of the sole proprietorship form of organisation are as follows:

(i) Formation and closure: There is no separate law that governs sole proprietorship. Hardly any legal formalities are required to start a sole proprietary business, though in some cases one may require a license. Closure of the business can also be done easily. Thus, there is ease in formation as well as closure of business.

(ii) Liability: Sole proprietors have unlimited liability. This implies that the owner is personally responsible for payment of debts in case the assets of the business are not sufficient to meet all the debts. As such the owner's personal possessions such as his/her personal car and other assets could be sold for repaying the debt. Suppose the total outside liabilities of XYZ dry cleaner, a sole proprietorship firm, are Rs. 80,000 at the time of dissolution, but its assets are Rs. 60,000 only. In such a situation the proprietor will have to bring in Rs. 20,000 from her personal sources even if she has to sell her personal property to repay the firm's debts.

(iii) Sole risk bearer and profit recipient: The risk of failure of business is borne all alone by the sole proprietor. However, if the business is successful, the proprietor enjoys all the benefits. He receives all the business profits which become a direct reward for his risk bearing.

(iv) Control: The right to run the business and make all decisions lies absolutely with the sole proprietor. He can carry out his plans without any interference from others.

(v) No separate entity: In the eyes of the law, no distinction is made between the sole trader and his business, as business does not have an identity separate from the owner. The owner is, therefore, held responsible for all the activities of the business.

(vi) Lack of business continuity: The sale proprietorship business is owned and controlled by one person, therefore death, insanity, imprisonment, physical ailment or bankruptcy of the sole proprietor will have a direct and detrimental effect on the business and may even cause closure of the business.

Merits

Sole proprietorship offers many advantages. Some of the important ones are as follows:

(i) Quick decision making: A sole proprietor enjoys considerable degree of freedom in making business decisions. Further the decision making is prompt because there is no need to consult others. This may lead to timely capitalisation of market opportunities as and when they arise.

(ii) Confidentiality of information: Sole decision making authority enables the proprietor to keep all the information related to business operations confidential and maintain

A Refreshing Start: Coca Cola Owes its Origin to a Sole Proprietor!

The product that has given the world its best-known taste was born in Atlanta, Georgia, on May 8, 1886. Dr. John Stith Pemberton, a local pharmacist, produced the syrup for Coca-Cola®, and carried a jug of the new product down the street to Jacobs' Pharmacy, where it was sampled, pronounced "excellent" and placed on sale for five cents a glass as a soda fountain drink. Dr. Pemberton never realised the potential of the beverage he created. He gradually sold portions of his business to various partners and, just prior to his death in 1888, sold his remaining interest in Coca-Cola to Asa G. Candler. An Atlantan with great business acumen, Mr. Candler proceeded to buy additional business rights and acquire complete control.

On May 1, 1889, Asa Candler published a full-page advertisement in *The Atlanta Journal*, proclaiming his wholesale and retail drug business as *"**sole proprietors of Coca-Cola ... Delicious. Refreshing. Exhilarating. Invigorating.**"* Sole ownership, which Mr. Candler did not actually achieve until 1891, needed an investment of $ 2,300.

It was only in 1892 that Mr. Candler formed a company called The Coca-Cola Corporation.

Source: *Website of Coca Cola company.*

secrecy. A sole trader is also not bound by law to publish firm's accounts.

(iii) Direct incentive: A sole proprietor directly reaps the benefits of his/her efforts as he/she is the sole recipient of all the profit. The need to share profits does not arise as he/she is the single owner. This provides maximum incentive to the sole trader to work hard.

(iv) Sense of accomplishment: There is a personal satisfaction involved in working for oneself. The knowledge that one is responsible for the success of the business not only contributes to self-satisfaction but also instils in the individual a sense of accomplishment and confidence in one's abilities.

(v) Ease of formation and closure: An important merit of sole proprietorship is the possibility of entering into business with minimal legal formalities. There is no separate law that governs sole proprietorship. As sole proprietorship is the least regulated form of business, it is easy to start and close the business as per the wish of the owner.

Limitations

Notwithstanding various advantages, the sole proprietorship form of organisation is not free from limitations. Some of the major limitations of sole proprietorship are as follows:

(i) Limited resources: Resources of a sole proprietor are limited to his/her personal savings and borrowings from others. Banks and other lending institutions may hesitate to extend a long term loan to a sole proprietor. Lack of resources is one of the major reasons why the size of the business rarely grows much and generally remains small.

(ii) Limited life of a business concern: The sole proprietorship business is owned and controlled by one person, so death, insanity, imprisonment, physical ailment or bankruptcy of a proprietor affects the business and can lead to its closure.

(iii) Unlimited liability: A major disadvantage of sole proprietorship is that the owner has unlimited liability. If the business fails, the creditors can recover their dues not merely from the business assets, but also from the personal assets of the proprietor. A poor decision or an unfavourable circumstance can create serious financial burden on the owner. That is why a sole proprietor is less inclined to take risks in the form of innovation or expansion.

(iv) Limited managerial ability: The owner has to assume the responsibility of varied managerial tasks such as purchasing, selling, financing, etc. It is rare to find an individual who excels in all these areas. Thus decision making may not be balanced in all the cases. Also, due to limited resources, sole proprietor may not be able to employ and retain talented and ambitious employees.

Though sole proprietorship suffers from various shortcomings, many entrepreneurs opt for this form of organisation because of its inherent advantages. It requires less amount of capital. It is best suited for businesses which are carried out on a small scale and where customers demand personalised services.

2.3 Joint Hindu Family Business

Joint Hindu family business is a specific form of business organisation found only in India. It is one of the oldest forms of business organisation in the country. It refers to a form of organisation wherein the business is owned and carried on by the members of the Hindu Undivided Family (HUF). It is governed by the Hindu Law. The basis of membership in the business is birth in a particular family and three successive generations can be members in the business.

The business is controlled by the head of the family who is the eldest member and is called *karta*. All members have equal ownership right over the property of an ancestor and they are known as *co-parceners*.

Features

The following points highlight the essential characteristics of the joint Hindu family business.

(i) Formation: For a joint Hindu family business, there should be at least two members in the family and ancestral property to be inherited by them. The business does not require any agreement as membership is by birth. It is governed by the Hindu Succession Act, 1956.

(ii) Liability: The liability of all members except the *karta* is limited to their share of co-parcenery property of the business. The *karta*, however, has unlimited liability.

(iii) Control: The control of the family business lies with the *karta*. He takes all the decisions and is authorised to manage the business. His decisions are binding on the other members.

(iv) Continuity: The business continues even after the death of the *karta* as the next eldest member takes up the position of *karta*, leaving the business stable. The business can,

Gender Equality in the Joint Hindu Family a Reality

According to the Hindu Succession (Amendment) Act, 2005, the daughter of a coparcener of a Joint Hindu Family shall, by birth, become a coparcener. At the time of partition of such a 'Joint Hindu Family' the coparcenary property shall be equally divided to all the coparceners irrespective of their gender (male or female). The eldest member (male or female) of 'Joint Hindu Family' shall become *Karta*. Married daughter has equal rights in property of a Joint Hindu Family.

however, be terminated with the mutual consent of the members.

(v) Minor Members: The inclusion of an individual into the business occurs due to birth in a Hindu Undivided Family. Hence, minors can also be members of the business.

Merits

The advantages of the joint Hindu family business are as follows:

(i) Effective control: The *karta* has absolute decision making power. This avoids conflicts among members as no one can interfere with his right to decide. This also leads to prompt and flexible decision making.

(ii) Continued business existence: The death of the *karta* will not affect the business as the next eldest member will then take up the position. Hence, operations are not terminated and continuity of business is not threatened.

(iii) Limited liability of members: The liability of all the co-parceners except the *karta* is limited to their share in the business, and consequently their risk is well-defined and precise.

(iv) Increased loyalty and cooperation: Since the business is run by the members of a family, there is a greater sense of loyalty towards one other. Pride in the growth of business is linked to the achievements of the family. This helps in securing better cooperation from all the members.

Limitation

The following are some of the limitations of a joint Hindu family business.

(i) Limited resources: The joint Hindu family business faces the problem of limited capital as it depends mainly on ancestral property. This limits the scope for expansion of business.

(ii) Unlimited liability of *karta*: The *karta* is burdened not only with the responsibility of decision making and management of business, but also suffers from the disadvantage of having unlimited liability. His personal property can be used to repay business debts.

(iii) Dominance of *karta*: The *karta* individually manages the business which may at times not be acceptable to other members. This may cause conflict amongst them and may even lead to break down of the family unit.

(iv) Limited managerial skills: Since the *karta* cannot be an expert in all areas of management, the business may suffer as a result of his unwise decisions. His inability to decide effectively may result into poor profits or even losses for the organisation.

The joint Hindu family business is on the decline because of the diminishing number of joint Hindu families in the country.

2.4 Partnership

The inherent disadvantage of the sole proprietorship in financing and managing an expanding business paved the way for partnership as a viable option. Partnership serves as an answer to the needs of greater capital investment, varied skills and sharing of risks.

> Partnership is the relation between persons competent to make contracts who have agreed to carry on a lawful business in common with a view to private gain.
>
> *L H Haney*
>
> Partnership is the relation which subsists between persons who have agreed to combine their property, labour or skill in some business and to share the profits therefrom between them.
>
> *The Indian Contract Act* 1872

The Indian Partnership Act, 1932 defines partnership as "the relation between persons who have agreed to share the profit of the business carried on by all or any one of them acting for all."

Features

Definitions given above point to the following major characteristics of the partnership form of business organisation.

(i) Formation: The partnership form of business organisation is governed by the Indian Partnership Act, 1932. It comes into existence through a legal agreement wherein the terms and conditions governing the relationship among the partners, sharing of profits and losses and the manner of conducting the business are specified. It may be pointed out that the business must be lawful and run with the motive of profit. Thus, two people coming together for charitable purposes will not constitute a partnership.

(ii) Liability: The partners of a firm have unlimited liability. Personal assets may be used for repaying debts in case the business assets are insufficient. Further, the partners are jointly and individually liable for payment of debts. Jointly, all the partners are responsible for the debts and they contribute in proportion to their share in business and as such are liable to that extent. Individually too, each partner can be held responsible repaying the debts of the business. However, such a partner can later recover from other partners an amount of money equivalent to the shares in liability defined as per the partnership agreement.

(iii) Risk bearing: The partners bear the risks involved in running a business as a team. The reward comes in the form of profits which are shared by the partners in an agreed ratio. However, they also share losses in the same ratio in the event of the firm incurring losses.

(iv) Decision making and control: The partners share amongst themselves the responsibility of decision making and control of day to day activities. Decisions are generally taken with mutual consent. Thus, the activities of a partnership firm are managed through the joint efforts of all the partners.

(v) Continuity: Partnership is characterised by lack of continuity of business since the death, retirement, insolvency or insanity of any partner can bring an end to the business. However, the remaining partners may if they so desire continue the business on the basis of a new agreement.

(vi) Number of Partners: The minimum number of partners needed to start a partnership firm is two. According to section 464 of the Companies Act 2013, maximum number of partners in a partnership firm can be 100, subject to the number prescribed by the government. As per Rule 10 of The Companies (miscelleneous) Rules 2014, at present the maximum number of members can be 50.

(vii) Mutual agency: The definition of partnership highlights the fact that it is a business carried on by all or any one of the partners acting for all. In other words, every partner is both an agent and a principal. He is an agent of other partners as he represents them and thereby binds them through his acts. He is a principal as he too can be bound by the acts of other partners.

Merits

The following points describe the advantages of a partnership firm.

(i) Ease of formation and closure: A partnership firm can be formed easily by putting an agreement between the prospective partners into place whereby they agree to carryout the business of the firm and share risks. There is no compulsion with respect to registration of the firm. Closure of the firm too is an easy task.

(ii) Balanced decision making: The partners can oversee different functions according to their areas of expertise. Because an individual is not forced to handle different activities, this not only reduces the burden of work but also leads to fewer errors in judgements. As a consequence, decisions are likely to be more balanced.

(iii) More funds: In a partnership, the capital is contributed by a number of partners. This makes it possible to raise larger amount of funds as compared to a sole proprietor and undertake additional operations when needed.

(iv) Sharing of risks: The risks involved in running a partnership firm are shared by all the partners. This reduces the anxiety, burden and stress on individual partners.

(v) Secrecy: A partnership firm is not legally required to publish its accounts and submit its reports. Hence it is able to maintain confidentiality of information relating to its operations.

Limitations

A partnership firm of business organisation suffers from the following limitations:

(i) Unlimited liability: Partners are liable to repay debts even from their personal resources in case the business assets are not sufficient to meet its debts. The liability of partners is both joint and several which may prove to be a drawback for those partners who have greater personal wealth. They will have to repay the entire debt in case the other partners are unable to do so.

(ii) Limited resources: There is a restriction on the number of partners, and hence contribution in terms of capital investment is usually not sufficient to support large scale business operations. As a result, partnership firms face problems in expansion beyond a certain size.

(iii) Possibility of conflicts: Partnership is run by a group of persons wherein decision making authority is shared. Difference in opinion on some issues may lead to disputes between partners. Further, decisions of one partner are binding on other partners. Thus an unwise decision by some one may result in financial ruin for all others. In case a partner desires to leave the firm, this can result in termination of partnership as there is a restriction on transfer of ownership.

(iv) Lack of continuity: Partnership comes to an end with the death, retirement, insolvency or lunacy of any partner. It may result in lack of continuity. However, the remaining partners can enter into a fresh agreement and continue to run the business.

(v) Lack of public confidence: A partnership firm is not legally required to publish its financial reports or make other related information public. It is, therefore, difficult for any member of the public to ascertain the true financial status of a partnership firm. As a result, the confidence of the public in partnership firms is generally low.

2.4.1 Types of Partners

A partnership firm can have different types of partners with different roles and liabilities. An understanding of these types is important for a clear understanding of their rights and responsibilities. These are described as follows:

(i) Active partner: An active partner is one who contributes capital, participates in the management of the firm, shares its profits and losses, and is liable to an unlimited extent to the creditors of the firm. These partners take actual part in carrying out business of the firm on behalf of other partners.

(ii) Sleeping or dormant partner: Partners who do not take part in the day to day activities of the business are called sleeping partners. A sleeping partner, however, contributes capital to the firm, shares its profits and losses, and has unlimited liability.

(iii) Secret partner: A secret partner is one whose association with the firm is unknown to the general public. Other than this distinct feature, in all other aspects he is like the rest of the partners. He contributes to the capital of the firm, takes part in the management, shares its profits and losses, and has unlimited liability towards the creditors.

(iv) Nominal partner: A nominal partner is one who allows the use of his/her name by a firm, but does not contribute to its capital. He/she does not take active part in managing the firm, does not share its profit or losses but is liable, like other partners, to the third parties, for the repayments of the firm's debts.

(v) Partner by estoppel: A person is considered a partner by estoppel if, through his/her own initiative, conduct or behaviour, he/she gives an impression to others that he/she is a partner of the firm. Such partners are held liable for the debts of the firm because in the eyes of the third party they are considered partners, even though they do not contribute capital or take part in its management. Suppose Rani is a friend of Seema who is a partner in a software firm — Simplex Solutions. On Seema's request, Rani accompanies her to a business meeting with Mohan Softwares and actively participates in the negotiation process for a business deal and gives the impression that she

Table 2.1 Types of Partners

Type	Capital contribution	Management	Share in profits/ losses	Liability
Active partner	Contributes capital	Participates in management	Shares profits/ losses	Unlimited liability
Sleeping or dormant partner	Contributes capital	Does not participate in management	Shares profits/ losses	Unlimited liability
Secret partner	Contributes capital	Participates in management, but secretly	Shares profits/ losses	Unlimited liability
Nominal partner	Does not contribute capital	Does not participate in management	Generally does not share profits/ losses	Unlimited liability
Partner by estoppel	Does not contribute capital	Does not participate in management	Does not share profits/ losses	Unlimited liability
Partner by holding out	Does not contribute capital	Does not participate in management	Does not share profits/ losses	Unlimited liability

Minor as a Partner

Partnership is based on legal contract between two persons who agree to share the profits or losses of a business carried on by them. As such a minor is incompetent to enter into a valid contract with others, he cannot become a partner in any firm. However, a minor can be admitted to the benefits of a partnership firm with the mutual consent of all other partners. In such cases, his liability will be limited to the extent of the capital contributed by him and in the firm. He will not be eligible to take an active part in the management of the firm. Thus, a minor can share only the profits and can not be asked to bear the losses. However, he can if he wishes, inspect the accounts of the firm. The status of a minor changes when he attains majority. In fact, on attaining majority, the minor has to decide whether he would like to become a partner in the firm. He has to give a public notice of his decision within six months of attaining majority. If he fails to do so, within the stipulated time, he will be treated as a full-fledged partner and will become liable to the debts of the firm to an unlimited extent, in the same way as other active partners are.

is also a partner in Simplex Solutions. If credit is extended to Simplex Solutions on the basis of these negotiations, Rani would also be liable for repayment of such debt, as if she is a partner of the firm.

(vi) Partner by holding out: A partner by 'holding out' is a person who though is not a partner in a firm but knowingly allows himself/herself to be represented as a partner in a firm. Such a person becomes liable to outside creditors for repayment of any debts which have been extended to the firm on the basis of such representation. In case he is not really a partner and wants to save himself from such a liability, he should immediately issue a denial, clarifying his position that he is not a partner in the firm. If he does not do so, he will be responsible to the third party for any such debts.

2.4.2 Types of Partnerships

Partnerships can be classified on the basis of two factors, viz., duration and liability. On the basis of duration, there can be two types of partnerships : 'partnership at will' and 'particular partnership'. On the basis of liability, the two types of partnership include: one 'with limited liability' and the other one 'with unlimited liability'. These types are described in the following sections.

Classification on the basis of duration

(i) Partnership at will: This type of partnership exists at the will of the partners. It can continue as long as the partners want and is terminated when any partner gives a notice of withdrawal from partnership to the firm.

(ii) Particular partnership: Partnership formed for the accomplishment of a particular project say construction of a building or an activity to be carried on for a specified time period is called particular partnership. It dissolves automatically when the purpose for which it was formed is fulfilled or when the time duration expires.

Classification on the basis of liability

(i) General Partnership: In general partnership, the liability of partners is unlimited and joint. The partners enjoy the right to participate in the management of the firm and their acts are binding on each other as well as on the firm. Registration of the firm is optional. The existence of the firm is affected by the death, lunacy, insolvency or retirement of the partners.

(ii) Limited Partnership: In limited partnership, the liability of at least one partner is unlimited whereas the rest may have limited liability. Such a partnership does not get terminated with the death, lunacy or insolvency of the limited partners. The limited partners do not enjoy the right of management and their acts do not bind the firm or the other partners. Registration of such partnership is compulsory.

This form of partnership was not permitted in India earlier. The permission to form partnership firms with limited liability has been granted after introduction of New Small Enterprise Policy in 1991. The idea behind such a move has been to enable the partnership firms to attract equity capital from friends and relatives of small scale entrepreneurs who were earlier reluctant to help, due to the existence of unlimited liability clause in the partnership form of business.

2.4.3 Partnership Deed

A partnership is a voluntary association of people who come together for achieving common objectives. In order to enter into partnership, a clear agreement with respect to the terms, conditions and all aspects concerning

Price Waterhouse Coopers was a Partnership Firm earlier

Price Waterhouse Coopers, one of the world's top accountancy firms has been created in 1998 by the merger of two companies, Price Waterhouse and Coopers and Lybrand — each with historical roots going back some 150 years to the 19th century Great Britain. In 1850, Samuel Lowell Price set up his accounting business in London. In 1865, he was joined in partnership by William H. Holyland and Edwin Waterhouse. As the firm grew, qualified members of its professional staff were admitted to the partnership. By the late 1800s, Price Waterhouse had gained significant recognition as an accounting firm.

Source: *Price Waterhouse Coopers archives in Columbia University.*

the partners is essential so that there is no misunderstanding later among the partners. Such an agreement can be oral or written. Even though it is not essential to have a written agreement, it is advisable to have a written agreement as it constitutes an evidence of the conditions agreed upon. The written agreement which specifies the terms and conditions that govern the partnership is called the partnership deed.

The partnership deed generally includes the following aspects:

- Name of firm
- Nature of business and location of business
- Duration of business
- Investment made by each partner
- Distribution of profits and losses
- Duties and obligations of the partners
- Salaries and withdrawals of the partners
- Terms governing admission, retirement and expulsion of a partner
- Interest on capital and interest on drawings
- Procedure for dissolution of the firm
- Preparation of accounts and their auditing
- Method of solving disputes

2.4.4 Registration

Registration of a partnership firm means the entering of the firm's name, along with the relevant prescribed particulars, in the Register of firms kept with the Registrar of Firms. It provides conclusive proof of the existence of a partnership firm.

It is optional for a partnership firm to get registered. In case a firm does not get registered, it is deprived of many benefits. The consequences of non-registration of a firm are as follows:

(a) A partner of an unregistered firm cannot file a suit against the firm or other partners,

(b) The firm cannot file a suit against third parties, and

(c) The firm cannot file a case against the partners.

In view of these consequences, it is therefore advisable to get the firm registered. According to the India Partnership Act 1932, the partners may get the firm registered with the Registrar of firms of the state in which the firm is situated. The registration can be at the time of formation or at any time during its existence. The procedure for getting a firm registered is as follows:

1. Submission of application in the prescribed form to the Registrar of firms. The application should contain the following particulars:
   - Name of the firm
   - Location of the firm
   - Names of other places where the firm carries on business
   - The date when each partner joined the firm
   - Names and addresses of the partners
   - Duration of partnership

This application should be signed by all the partners.

2. Deposit of required fees with the Registrar of Firms.
3. The Registrar after approval will make an entry in the register of firms and will subsequently issue a certificate of registration.

Cooperative is a form of organisation wherein persons voluntarily associate together as human beings on the basis of equality for the promotion of an economic interest for themselves.

E. H. Calvert

Cooperative organisation is "a society which has its objectives for the promotion of economic interests of its members in accordance with cooperative principles.

The Indian Cooperative Societies Act 1912

2.5 Cooperative Society

The word cooperative means working together and with others for a common purpose.

The cooperative society is a voluntary association of persons, who join together with the motive of welfare of the members. They are driven by the need to protect their economic interests in the face of possible exploitation at the hands of middlemen obsessed with the desire to earn greater profits.

The cooperative society is compulsorily required to be registered under the Cooperative Societies Act 1912. The process of setting up a cooperative society is simple enough and at the most what is required is the consent of at least ten adult persons to form a society. The capital of a society is raised from its members through issue of shares. The society acquires a distinct legal identity after its registration.

Features

The characteristics of a cooperative society are listed below.

(i) Voluntary membership: The membership of a cooperative society is voluntary. A person is free to join a cooperative society, and can also leave anytime as per his desire. There cannot be any compulsion for him to join or quit a society. Although procedurally a member is required to serve a notice before leaving the society, there is no compulsion to remain a member. Membership is open to all, irrespective of their religion, caste, and gender.

(ii) Legal status: Registration of a cooperative society is compulsory. This accords a separate identity to the society which is distinct from its members. The society can enter into contracts and hold property in its name, sue and be sued by others. As a result of being a separate legal entity, it is not affected by the entry or exit of its members.

(iii) Limited liability: The liability of the members of a cooperative society is limited to the extent of the amount contributed by them as capital. This defines the maximum risk that a member can be asked to bear.

(iv) Control: In a cooperative society, the power to take decisions lies in the hands of an elected managing committee. The right to vote gives the members a chance to choose the members who will constitute the managing committee and this lends the cooperative society a democratic character.

(v) Service motive: The cooperative society through its purpose lays emphasis on the values of mutual help and welfare. Hence, the motive of service dominates its working. If any surplus is generated as a result of its operations, it is distributed amongst the members as dividend in conformity with the bye-laws of the society.

Merits

The cooperative society offers many benefits to its members. Some of the advantages of the cooperative form of organisation are as follows.

(i) Equality in voting status: The principle of 'one man one vote' governs the cooperative society. Irrespective of the amount of capital contribution by a member, each member is entitled to equal voting rights.

(ii) Limited liability: The liability of members of a cooperative society is limited to the extent of their capital contribution. The personal assets of the members are, therefore, safe from being used to repay business debts.

(iii) Stable existence: Death, bankruptcy or insanity of the members do not affect continuity of a cooperative society. A society, therefore, operates unaffected by any change in the membership.

(iv) Economy in operations: The members generally offer honorary services to the society. As the focus is on elimination of middlemen, this helps in reducing costs. The customers or producers themselves are members of the society, and hence the risk of bad debts is lower.

(v) Support from government: The cooperative society exemplifies the idea of democracy and hence finds support from the Government in the form of low taxes, subsidies, and low interest rates on loans.

(vi) Ease of formation: The cooperative society can be started with a minimum of ten members. The registration procedure is simple involving a few legal formalities. Its formation is governed by the provisions of Cooperative Societies Act 1912.

Limitations

The cooperative form of organisation suffers from the following limitations:

(i) Limited resources: Resources of a cooperative society consists of capital contributions of the members with limited means. The low rate of dividend offered on investment also acts as a deterrent in attracting membership or more capital from the members.

(ii) Inefficiency in management: Cooperative societies are unable to attract and employ expert managers because of their inability to pay them high salaries. The members who offer honorary services on a voluntary basis are generally not professionally equipped to handle the management functions effectively.

(iii) Lack of secrecy: As a result of open discussions in the meetings of members as well as disclosure obligations as per the Societies Act

(7), it is difficult to maintain secrecy about the operations of a cooperative society.

(iv) Government control: In return of the privileges offered by the government, cooperative societies have to comply with several rules and regulations related to auditing of accounts, submission of accounts, etc. Interference in the functioning of the cooperative organisation through the control exercised by the state cooperative departments also negatively affects its freedom of operation.

(v) Differences of opinion: Internal quarrels arising as a result of contrary viewpoints may lead to difficulties in decision making. Personal interests may start to dominate the welfare motive and the benefit of other members may take a backseat if personal gain is given preference by certain members.

2.5.1 Types of Cooperative Societies

Various types of cooperative societies based on the nature of their operations are described below:

(i) Consumer's cooperative societies: The consumer cooperative societies are formed to protect the interests of consumers. The members comprise of consumers desirous of obtaining good quality products at reasonable prices. The society aims at eliminating middlemen to achieve economy in operations. It purchases goods in bulk directly from the wholesalers and sells goods to the members, thereby eliminating the middlemen. Profits, if any, are distributed on the basis of either their capital contributions to the society or purchases made by individual members.

Amul's amazing Cooperative ventures!

Every day Amul collects 4,47,000 litres of milk from 2.12 million farmers (many illiterate), converts the milk into branded, packaged products, and delivers goods worth Rs. 6 crore (Rs. 60 million) to over 5,00,000 retail outlets across the country.

It all started in December 1946 with a group of farmers keen to free themselves from intermediaries, gain access to markets and thereby ensure maximum returns for their efforts. Based in the village of Anand, the Khera District Milk Cooperative Union (better known as Amul) expanded exponentially. It joined hands with other milk cooperatives, and the Gujarat network now covers 2.12 million farmers, 10,411 village level milk collection centres and fourteen district level plants (unions). Amul is the common brand for most product categories produced by various unions: liquid milk, milk powder, butter, *ghee*, cheese, cocoa products, sweets, ice-cream and condensed milk. Amul's sub-brands include variants such as Amulspray, Amulspree, Amulya and Nutramul.

Source: *Adapted from Pankaj Chandra, "Rediff.com", Business Special, September 2005.*

(ii) Producer's cooperative societies: These societies are set up to protect the interest of small producers. The members comprise of producers desirous of procuring inputs for production of goods to meet the demands of consumers. The society aims to fight against the big capitalists and enhance the bargaining power of the small producers. It supplies raw materials, equipment and other inputs to the members and also buys their output for sale. Profits among the members are generally distributed on the basis of their contributions to the total pool of goods produced or sold by the society.

(iii) Marketing cooperative societies: Such societies are established to help small producers in selling their products. The members consist of producers who wish to obtain reasonable prices for their output. The society aims to eliminate middlemen and improve competitive position of its members by securing a favourable market for the products. It pools the output of individual members and performs marketing functions like transportation, warehousing, packaging, etc., to sell the output at the best possible price. Profits are distributed according to each member's contribution to the pool of output.

(iv) Farmer's cooperative societies: These societies are established to protect the interests of farmers by providing better inputs at a reasonable cost. The members comprise farmers

Indian Companies in League of FORTUNE GLOBAL Organisations

Company	GLOBAL rank	Rank in India	Revenue (Million$)	Website
Indian Oil Corporation Ltd.	161	1	54,711	www.iocl.com
Reliance Industries Ltd.	215	2	43,437	www.ril.com
Tata Motors Ltd.	226	3	42,092	www.tatamotors.com
State Bank of India	232	4	41,681	www.sbi.co.in
Bharat Petroleum Corporation Ltd.	350	5	20,082	www.bharatpetroleum.in
Hindustan Petroleum Corporation Ltd.	367	6	28,820	www.hindustanpetroleum.com
Rajesh Exports Corporation Ltd.	423	7	25,237	www.rajeshindia.com

who wish to jointly take up farming activities. The aim is to gain the benefits of large scale farming and increase the productivity. Such societies provide better quality seeds, fertilisers, machinery and other modern techniques for use in the cultivation of crops. This helps not only in improving the yield and returns to the farmers, but also solves the problems associated with the farming on fragmented land holdings.

(v) Credit cooperative societies: Credit cooperative societies are established for providing easy credit on reasonable terms to the members. The members comprise of persons who seek financial help in the form of loans. The aim of such societies is to protect the members from the exploitation of lenders who charge high rates of interest on loans. Such societies provide loans to members out of the amounts collected as capital and deposits from the members and charge low rates of interest.

(vi) Cooperative housing societies: Cooperative housing societies are established to help people with limited income to construct houses at reasonable costs. The members of these societies consist of people who are desirous of procuring residential accommodation at lower costs. The aim is to solve the housing problems of the members by constructing houses and giving the option of paying in instalments. These societies construct flats or provide plots to members on which the members themselves can construct the houses as per their choice.

2.6 Joint Stock Company

A company is an association of persons formed for carrying out business activities and has a legal status independent of its members. A company can be described as an artificial person having a separate legal entity, perpetual succession and a common seal. The company form of organisation is governed by The Companies Act, 2013. As per section 2(20) of Act 2013, a company means company incorporated under this Act or any other previous company law.

The shareholders are the owners of the company while the Board of Directors is the chief managing body elected by the shareholders. Usually, the owners exercise an indirect control over the business. The capital of the company is divided into smaller parts called 'shares' which can be transferred freely from one shareholder to another person (except in a private company).

Features

The definition of a joint stock company highlights the following features of a company.

(i) Artificial person: A company is a creation of law and exists independent of its members. Like natural persons, a company can own property, incur debts, borrow money, enter into contracts, sue and be sued but unlike them it cannot breathe, eat, run, talk and so on. It is, therefore, called an artificial person.

(ii) Separate legal entity: From the day of its incorporation, a company acquires an identity, distinct from its members. Its assets and liabilities are separate from those of its owners. The law does not recognise the business and owners to be one and the same.

(iii) Formation: The formation of a company is a time consuming, expensive and complicated process. It involves the preparation of several documents and compliance with several legal requirements before it can start functioning. Incorporation of companies is compulsory under The Companies Act 2013 or any of the previous company law, as state earlier. Such companies which are incorporated under companies Act 1956 or any company law shall be included in the list of companies.

Previous Company law means any of the laws specified below:
1. Act relating to companies in force before the Indian companies Act, 1866 (10 of 1866).
2. The Indian companies Act, 1866 (10 of 1866).
3. The Indian companies Act, 1882 (6 of 1882).
4. The Indian companies Act, 1913 (6 of 1913).
5. The Registration of Transferred Companies Ordinance, 1942 (ordinance 42 of 1942).
6. The Companies Act, 1956.

(iv) Perpetual succession: A company being a creation of the law, can be brought to an end only by law. It will only cease to exist when a specific procedure for its closure, called winding up, is completed. Members may come and members may go, but the company continues to exist.

(v) Control: The management and control of the affairs of the company is undertaken by the Board of Directors, which appoints the top management officials for running the business. The directors hold a position of immense significance as they are directly accountable to the shareholders for the working of the company. The shareholders, however, do not have the right to be involved in the day-to-day running of the business.

(vi) Liability: The liability of the members is limited to the extent of the capital contributed by them in a company. The creditors can use only the assets of the company to settle their claims since it is the company and not the members that owes the debt. The members can be asked to contribute to the loss only to the extent of the unpaid amount of share held by them. Suppose Akshay is a shareholder in a company holding 2,000 shares of Rs.10 each on which he has already paid Rs. 7 per share. His liability in the event of losses or company's failure to pay debts can be only up to Rs. 6,000 — the unpaid amount of his share capital (Rs. 3 per share on 2,000 shares held in the company). Beyond this, he is not liable to pay anything towards the debts or losses of the company.

(vii) Common seal: A company may or may not have a common seal. If a company has a common seal, it must be affixed to the documents such as agreements of a company. If a company does not have a common seal then the person signing the document should be authorised by a board's resolutions.

(viii) Risk bearing: The risk of losses in a company is borne by all the share holders. This is unlike the case of sole proprietorship or partnership firm where one or few persons respectively bear the losses. In the face of financial difficulties, all shareholders in a company have to contribute to the debts to the extent of their shares in the company's capital. The risk of loss thus gets spread over a large number of shareholders.

Merits

The company form of organisation offers a multitude of advantages, some of which are discussed below.

(i) Limited liability: The shareholders are liable to the extent of the amount unpaid on the shares held by them. Also, only the assets of the company can be used to settle the debts, leaving the owner's personal property free from any charge. This reduces the degree of risk borne by an investor.

(ii) Transfer of interest: The ease of transfer of ownership adds to the advantage of investing in a company as the share of a public limited company can be sold in the market and as such can be easily converted into cash in case the need arises. This avoids blockage of investment and presents the company as a favourable avenue for investment purposes.

(iii) Perpetual existence: Existence of a company is not affected by the death, retirement, resignation, insolvency or insanity of its members as it has a separate entity from its members. A company will continue to exist even if all the members die. It can be liquidated only as per the provisions of the Companies Act, 2013.

(iv) Scope for expansion: As compared to the sole proprietorship and partnership forms of organisation, a company has large financial resources. Further, capital can be attracted from the public as well as through loans from banks and financial institutions. Thus there is greater scope for expansion. The investors are inclined to invest in shares because of the limited liability, transferable ownership and possibility of high returns in a company.

(v) Professional management: A company can afford to pay higher salaries to specialists and professionals. It can, therefore, employ people who are experts in their area of specialisations. The scale of operations in a company leads to division of work. Each department deals with a particular activity and is headed by an expert. This leads to balanced decision making as well as greater efficiency in the company's operations.

Limitations

The major limitations of a company form of organisation are as follows:

(i) Complexity in formation: The formation of a company requires greater time, effort and extensive knowledge of legal requirements and the procedures involved. As compared to sole proprietorship and partnership form of organisations, formation of a company is more complex.

(iii) Impersonal work environment: Separation of ownership and management leads to situations in which there is lack of effort as well as personal involvement on the part of the officers of a company. The large size of a company further makes it difficult for the owners and top management to maintain personal contact with the employees, customers and creditors.

Pen is mightier than the Sword:
The Case of Luxor Writing Instruments Pvt. Ltd.

In the year 1963, a young gentleman armed with the power of hard work and ambition, started a new era in the field of writing instruments. At a tender age of 19, he started a small manual assembly shop in Sadar Bazaar area in Delhi where he manufactured fountain pens under the name **Luxor Writing Instruments Pvt. Ltd. (LWIPL).**

Being awarded the coveted ***'Number One Writing Instruments Exporter' award*** consecutively for three years, LWIPL has been given the exclusive rights of manufacturing and distributing four international brands in India, viz., **Pilot, Papermate, Parker and Waterman.**

Luxor Writing Instruments Pvt. Ltd. has the largest share of this market of over 20 percent, with a turnover pushing way beyond the Rs. 150 crore mark. As of today Luxor is a leading **manufacturer and exporter of writing instruments from India. It is currently exporting** over 15 percent of the output and has four manufacturing facilities in New Delhi and three at Mumbai. It employs over 600 people. It is the leader in most segments of the market, manufacturing and distributing a wide variety of pens for various applications and needs.

Source: *http://www.luxorparker.com*

(ii) Lack of secrecy: The Companies Act requires each public company to provide from time-to-time a lot of information to the office of the registrar of companies. Such information is available to the general public also. It is, therefore, difficult to maintain complete secrecy about the operations of company.

(iv) Numerous regulations: The functioning of a company is subject to many legal provisions and compulsions. A company is burdened with numerous restrictions in respect of aspects including audit, voting, filing of reports and preparation of documents, and is required to obtain various certificates from different agencies, viz., registrar, SEBI, etc. This reduces the freedom of operations of a company and takes away a lot of time, effort and money.

(v) Delay in decision making: Companies are democratically managed through the Board of Directors which is followed by the top management, middle management and lower level management. Communication as well as approval of various proposals may cause delays not only in taking decisions but also in acting upon them.

(vi) Oligarchic management: In theory, a company is a democratic institution wherein the Board of Directors are representatives of the shareholders who are the owners. In practice, however, in most large sized organisations having a multitude of shareholders; the owners have minimal influence in terms of controlling or running the business. It is so because the shareholders are spread all over the country and a very small percentage attend the general meetings. The Board of Directors as such enjoy considerable freedom in exercising their power which they sometimes use even contrary to the interests of the shareholders. Dissatisfied shareholders in such a situation have no option but to sell their shares and exit the company. As the directors virtually enjoy the rights to take all major decisions, it leads to rule by a few.

(vii) Conflict in interests: There may be conflict of interest amongst various stakeholders of a company. The employees, for example, may be interested in higher salaries, consumers desire higher quality products at lower prices, and the shareholders want higher returns in the form of dividends and increase in the intrinsic value of their shares. These demands pose problems in managing the company as it often becomes difficult to satisfy such diverse interests.

Table 2.3 Difference between a Public Company and Private Company

Basis	Public company	Private company
Members	Minimum - 7 Maximum - unlimited	Minimum - 2 Maximum - 200
Minimum number of directors	Three	Two
Index of members	Compulsory	Not compulsory
Transfer of shares	No restriction	Restriction on transfer
Invitation to public to subscribe to shares	Can invite the public to subscribe to its shares or debentures	Cannot invite the public to subscribe to its securities

Bharat Heavy Electricals Limited — A Public Company's Journey in Quality

Bharat Heavy Electricals Limited (BHEL) is the largest engineering and manufacturing enterprise in India today in the energy-related/ infrastructure sector.

BHEL was established more than 40 years ago, ushering in the indigenous heavy electrical equipment industry in India — a dream that has been more than realised with a well-recognised track record of performance. The company has been earning profits continuously since 1971-72 and paying dividends since 1976-77.

BHEL manufactures over 180 products under 30 major product groups and caters to core sectors of the Indian economy, viz., power generation and transmission, transportation, telecommunication, renewable energy, etc.

BHEL has acquired certifications to Quality Management Systems (ISO 9001), Environmental Management Systems (ISO 14001) and Occupational Health and Safety Management Systems (OHSAS 18001) and is also well on its journey towards Total Quality Management.

Major achievements of BHEL include:

- Installed equipment for over 90,000 MW of power generation — for utilities, captive and industrial users.
- Supplied over 2,25,000 MVA transformer capacity and other equipment operating in transmission and distribution network up to 400 kV (AC and DC).
- Supplied over 25,000 motors with Drive Control System to power projects, petrochemicals, refineries, steel, aluminium, fertiliser, cement plants, etc.
- Supplied traction electrics and AC/DC locos to power over 12,000 kms railway network.
- Supplied over one million valves to power plants and other industries.

BHEL's vision is to become a world-class engineering enterprise, committed to enhancing stakeholder value. The company is striving to give shape to its aspirations and fulfil the expectations of the country to become a global player.

The greatest strength of BHEL is its highly skilled and committed 43,500 employees. Every employee is given an equal opportunity to develop himself and grow in his career. Continuous training and retraining, career planning, a positive work culture and participative style of management — all these have engendered development of a committed and motivated workforce setting new benchmarks in terms of productivity, quality and responsiveness.

Source: *website of BHEL*

2.6.1 Types of Companies

A company can be either a private or a public company. These two types of companies are discussed in detail in the following paragraphs.

Private Company

A private company means a company which:

(a) restricts the right of members to transfer its shares;

(b) has a minimum of 2 and a maximum of 200 members, excluding the present and past employees;

(c) does not invite public to subscribe to its securities and

It is necessary for a private company to use the word *private limited* after its name. If a private company contravenes any of the aforesaid provisions, it ceases to be a private company and loses all the exemptions and privileges to which it is entitled.

The following are some of the *privileges* of a private limited company as against a public limited company:

1. A private company can be formed by only two members whereas seven people are needed to form a public company.
2. There is no need to issue a prospectus as public is not invited to subscribe to the shares of a private company.
3. Allotment of shares can be done without receiving the minimum subscription. A private limited company can start business as soon as it receives the certificate of incorporation.
4. A private company needs to have only two directors as against the minimum of three directors in the case of a public company. However the maximum number of directors for both types of companies is fifteen.
5. A private company is not required to keep an index of members while the same is necessary in the case of a public company.

Public Company

A public company means a company which is not a private company. As per The Companies Act, a public company is one which:

(a) has a minimum of 7 members and no limit on maximum members;

(b) has no restriction on transfer securities; and

(c) is not prohibited from inviting the public to subscribe to its securities.

However, a private company which is a subsidiary of a public company is also treated as a public company.

2.7 Choice of form of Business Organisation

After studying various forms of business organisations, it is evident that each form has certain advantages as well as disadvantages. It, therefore, becomes vital that certain basic considerations are kept in mind while choosing an appropriate form of organisation. The important factors determining the choice of organisation are listed in Table 2.4 and are discussed as follows:

Table 2.4 Factors influencing the choice of form of Business Organisation

	Form of organisation	
Factor	**Most advantageous**	**Least advantageous**
Availability of capital	Company	Sole proprietorship
Cost of formation	Sole proprietorship	Company
Ease of formation	Sole proprietorship	Company
Transfer of ownership	Company (except private company)	Partnership
Managerial skills	Company	Sole proprietorship
Regulations	Sole proprietorship	Company
Flexibility	Sole proprietorship	Company
Continuity	Company	Sole proprietorship
Liability	Company	Sole proprietorship

(i) Cost and ease in setting up the organisation: As far as initial business setting-up costs are concerned, sole proprietorship is the most inexpensive way of starting a business. However, the legal requirements are minimum and the scale of operations is small. In case of partnership also, the advantage of less legal formalities and lower cost is there because of limited scale of operations. Cooperative societies and companies have to be compulsorily registered. Formation of a company involves a lengthy and expensive legal procedure. From the point of view of initial cost, therefore, sole proprietorship is the preferred form as it involves least expenditure. Company form of organisation, on the other hand, is more complex and involves greater costs.

(ii) Liability: In case of sole proprietorship and partnership firms, the liability of the owners/partners is unlimited. This may call for paying the debt from personal assets of the owners. In joint Hindu family business, only the *karta* has unlimited liability. In cooperative societies and companies, however, liability is limited and creditors can force payment of their claims only to the extent of the company's assets. Hence, from the point of view of investors, the company form of organisation is more suitable as the risk involved is limited.

(iii) Continuity: The continuity of sole proprietorship and partnership firms is affected by such events as death, insolvency or insanity of the owners. However, such factors do not affect the continuity of business in the case of organisations like joint Hindu family business, cooperative societies and

Table 2.5 Comparative Evaluation of Forms of Organisation

Basis of comparison	Sole proprietorship	Partnership	Joint Hindu family business	Cooperative society	Company
Formation	Minimal legal formalities, easiest formation	Registration is optional, easy formation	Less legal formalities, exemption from registration, easy formation	Registration compulsory, greater legal formalities	Registration compulsory, lengthy and expensive formation process
Members	Only owner	Minimum-2 Maximum: 50	At least two persons for division of family property, no maximum limit	At least 10 adults, no maximum limit	Minimum Private-2 Public Company-7 Maximum Private Company-200 Public Company-unlimited
Capital contribution	Limited finance	Limited but more than that can be raised in case of sole proprietorship	Ancestral property	Limited	Large financial resources
Liability	Unlimited	Unlimited and joint	Unlimited *(Karta)*, Limited (Other members)	Limited	Limited
Control and management	Owner takes all decisions, quick decision making	Partners take decisions, consent of all partners is needed	Karta takes decisions	Elected representative, i.e., managing committee takes decisions	Separation between ownership and management
Continuity	Unstable, business and owner regarded as one	More stable but affected by status of partners	Stable business, continues even if *karta* dies	Stable because of separate legal status	Stable because of separate legal status

companies. In case the business needs a permanent structure, company form is more suitable. For short term ventures, proprietorship or partnership may be preferred.

(iv) Management ability: A sole proprietor may find it difficult to have expertise in all functional areas of management. In other forms of organisations like partnership and company, there is no such problem. Division of work among the members in such organisations allows the managers to specialise in specific areas, leading to better decision making. But this may lead to situations of conflicts because of differences of opinion amongst people. Further, if the organisation's operations are complex in nature and require professionalised management, company form of organisation is a better alternative. Proprietorship or partnership may be suitable, where simplicity of operations allow even people with limited skills to run the business. Thus, the nature of operations and the need for professionalised management affect the choice of the form of organisation.

(v) Capital considerations: Companies are in a better position to collect large amounts of capital by issuing shares to a large number of investors. Partnership firms also have the advantage of combined resources of all partners. But the resources of a sole proprietor are limited. Thus, if the scale of operations is large, company form may be suitable whereas for medium and small sized business one can opt for partnership or sole proprietorship. Further, from the point of view of expansion, a company is more suitable because of its capability to raise more funds and invest in expansion plans. It is precisely for this purpose that in our opening case Neha's father suggested she should consider switching over to the company form of organisation.

(vi) Degree of control: If direct control over operations and absolute decision making power is required, proprietorship may be preferred. But if the owners do not mind sharing control and decision making, partnership or company form of organisation can be adopted. The added advantage in the case of company form of organisation is that there is complete separation of ownership and management and it is professionals who are appointed to independently manage the affairs of a company.

(vii) Nature of business: If direct personal contact is needed with the customers such as in the case of a grocery store, proprietorship may be more suitable. For large manufacturing units, however, when direct personal contact with the customer is not required, the company form of organisation may be adopted. Similarly, in cases where services of a professional nature are required, partnership form is much more suitable.

It would not be out of place to mention here that the factors stated above are inter-related. Factors like capital contribution and risk vary with the size and nature of business, and hence a form of business organisation that is suitable from the point of view of the risks for a given business when run on a small scale might not be appropriate when the same business is carried on a large scale. It is, therefore, suggested that all the relevant factors must be taken into consideration while making a decision with respect to the form of organisation that should be adopted.

Key Terms

Sole proprietorship	Partnership	Joint Hindu Family
Mutual agency	Cooperative Societies	Joint Stock Company
Perpetual succession	Artificial person	Holding company
Co-parceners	Incorporation of a Company	

SUMMARY

Forms of business organisation refers to the types of organisations which differ in terms of ownership and management. The major forms of organisation include proprietorship, partnership, joint Hindu family business, cooperative society and company.

Sole proprietorship refers to a form of organisation where business is owned, managed and controlled by a single individual who bears all the risks and is the only recipient of all the profits. Merits of this form of organisation include quick decision making, direct incentive, personal satisfaction, and ease of formation and closure. But this form of organisation suffers from limitations of limited resources, unstable life span of business, unlimited liability of sole proprietor and his/her limited managerial ability.

Partnership is defined as an association of two or more persons who agree to carry on a business together and share the profits as well as bear risks collectively. Major advantages of partnership are: ease of formation and closure, benefits of specialisation, greater funds, and reduction of risk. Major limitations of partnership are unlimited liability, possibility of conflicts, lack of continuity and lack of public confidence. As there are different types of partners such as active, sleeping, secret and nominal partners; so is the case with types of partnerships which can vary from general partnership, limited partnership, partnership at will to particular partnership.

Joint Hindu family business is a business owned and carried on by the members of a Hindu Undivided Family, which is governed by the Hindu law. *Karta* — the oldest male member of the family — controls the business. The strong points of joint Hindu family business include effective control, stability in existence, limited liability and increased loyalty among family members. But this form of organisation too suffers from certain limitations such as limited resources, lack of incentives, dominance of the *karta* and limited managerial ability.

A cooperative society is a voluntary association of persons who get together to protect their economic interests. The major advantages of a cooperative society are equality in voting, members' limited liability, stable existence, economy in operations, support from government, and ease of formation. But this form of organisation suffers from weaknesses such as limited resources, inefficiency in management, lack of secrecy, government control, and differences among members in regard to the way society should be managed and organised. Based on their purpose and nature of members, various types of societies that can be formed include: consumers cooperative society, producers cooperative society, marketing cooperative society, farmers cooperative society, credit cooperative society, and cooperative housing society.

A company, on the other hand, may be defined as an artificial person, existing only in the eyes of the law with perpetual succession and having a separate legal identity. While major advantages of a company form of organisation are members' limited liability, transfer of interest, stable existence, scope for expansion, and professional management; its key limitations are: complexity in formation, lack of secrecy, impersonal work environment, numerous regulations, delay in decision making, oligarchic management, and conflict of interests among different shareholders.

Companies can be of two types — private and public. A private company is one which restricts transfer of shares and does not invite the public to subscribe to its securities. A public company, on the other hand, is allowed to raise its funds by inviting the public to subscribe to its securities. Furthermore, there is a free transferability of securities in the case of a public company.

Choice of form of organisation: Selection of an appropriate form of organisation can be made after taking various factors into consideration. Initial costs, liability, continuity, capital considerations, managerial ability, degree of control and nature of business are the key factors that need to taken into account while deciding about the suitable form of organisation for one's business.

EXERCISES

Multiple Choice Questions

Tick the appropriate answer

1. The structure in which there is separation of ownership and management is called
   (a) Sole proprietorship (b) Partnership
   (c) Company (d) All business organisations

2. The *karta* in Joint Hindu family business has
   (a) Limited liability (b) Unlimited liability
   (c) No liability for debts (d) Joint liability

3. In a cooperative society the principle followed is
   (a) One share one vote (b) One man one vote
   (c) No vote (d) Multiple votes

4. The board of directors of a joint stock company is elected by
   (a) General public (b) Government bodies
   (c) Shareholders (d) Employees

5. Profits do not have to be shared. This statement refers to
   (a) Partnership (b) Joint Hindu family business
   (c) Sole proprietorship (d) Company

6. The capital of a company is divided into number of parts each one of which are called
   (a) Dividend (b) Profit
   (c) Interest (d) Share

7. The Head of the joint Hindu family business is called
   (a) Proprietor (b) Director
   (c) *Karta* (d) Manager

8. Provision of residential accommodation to the members at reasonable rates is the objective of
   (a) Producer's cooperative (b) Consumer's cooperative
   (c) Housing cooperative (d) Credit cooperative

9. A partner whose association with the firm is unknown to the general public is called
   (a) Active partner (b) Sleeping partner
   (c) Nominal partner (d) Secret partner

Short Answer Questions

1. Compare the status of a minor in a Joint Hindu family business with that in a partnership firm.
2. If registration is optional, why do partnership firms willingly go through this legal formality and get themselves registered? Explain.
3. State the important privileges available to a private company.
4. How does a cooperative society exemplify democracy and secularism? Explain.
5. What is meant by 'partner by estoppel'? Explain.
6. Briefly explain the following terms in brief.
   (a) Perpetual succession (b) Common seal
   (c) *Karta* (d) Artificial person

Long Answer Questions

1. What do you understand by a sole proprietorship firm? Explain its merits and limitation?
2. Why is partnership considered by some to be a relatively unpopular form of business ownership? Explain the merits and limitations of partnership.
3. Why is it important to choose an appropriate form of organisation? Discuss the factors that determine the choice of form of organisation.
4. Discuss the characteristics, merits and limitation of cooperative form of organisation. Also describe briefly different types of cooperative societies.
5. Distinguish between a Joint Hindu family business and partnership.
6. Despite limitations of size and resources, many people continue to prefer sole proprietorship over other forms of organisation? Why?

Application Questions

1. In which form of organisation is a trade agreement made by one owner binding on the others? Give reasons to support your answer.
2. The business assets of an organisation amount to Rs. 50,000 but the debts that remain unpaid are Rs. 80,000. What course of action can the creditors take if
   (a) The organisation is a sole proprietorship firm
   (b) The organisation is a partnership firm with Anthony and Akbar as partners. Which of the two partners can the creditors approach for repayment of debt? Explain giving reasons

3. Kiran is a sole proprietor. Over the past decade, her business has grown from operating a neighbourhood corner shop selling accessories such as artificial jewellery, bags, hair clips and nail art to a retail chain with three branches in the city. Although she looks after the varied functions in all the branches, she is wondering whether she should form a company to better manage the business. She also has plans to open branches countrywide.

   (a) Explain two benefits of remaining a sole proprietor

   (b) Explain two benefits of converting to a joint stock company

   (c) What role will her decision to go nationwide play in her choice of form of the organisation?

   (d) What legal formalities will she have to undergo to operate business as a company?

Projects/Assignments

Divide students into teams to work on the following

(a) To study the profiles of any five neighbourhood grocery/stationery store

(b) To conduct a study into the functioning of a Joint Hindu family businesses

(c) To enquire into the profile of five partnerships firms

(d) To study the ideology and working of cooperative societies in the area

(e) To study the profiles of any five companies (inclusive of both private and public companies)

Notes

1. Some of the following aspects can be assigned to the students for undertaking above mentioned studies.

   Nature of business, size of the business measured in terms of capital employed, number of persons working, or sales turnover, problems faced, Incentive, reason behind choice of a particular form, decision making pattern, willingness to expand and relevant considerations, Usefulness of a form, etc.

2. Students teams should be encouraged to submit their findings and conclusions in the form of project reports and multi-media presentations.

Chapter 3

Private, Public and Global Enterprises

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- explain the concept and characteristics of business;
- explain the features of different forms of public enterprises viz., departmental, statutory corporations and government companies;
- critically examine the changing role of the public sector;
- explain the features of global enterprises; and
- appreciate the benefits of joint ventures.

Anita, a student of class XI, was going through some newspapers. The headlines stared at her face, Government plans to disinvest its shares in a few companies. The next day there was another news item on one public sector company incurring heavy losses and the proposal for closing the same. In contrast to this, she read another item on how some of the companies under the private sector were doing so well. She was actually curious to know what these terms like public sector, disinvestment, privatisation meant. She realised that in certain areas there was only the government which operates like the railways and in some areas both the privately owned and government run business were operating. For example, in the heavy industry sector SAIL, BHEL and TISCO, Reliance, Birlas all were there and in the telecom sector, companies like Tata, Reliance, Airtel operate and in airlines Sahara and Jet have recently gained entry. These companies along with the Government-owned companies like MTNL, BSNL, Indian Airlines, Air India. She then started wondering where from companies like Coca cola, Pepsi, Hyundai came? Were they always here or did they operate somewhere else, in some other country. She went to the library and was surprised to know that there was so much information about all these in books, business magazines and newspapers.

3.1 Introduction

You must have come across all types of business organisations in your daily life. In your neighbourhood market, there are shops owned by sole proprietors or big retail organisations run by a company. Then there are people providing you services like legal services, medical services, being owned by more than one person i.e., partnership firms. These are all privately owned organisations. Similarly, there are other offices or places of business which may be owned by the government. For example, Railways is an organisation wholly owned and managed by the government. The post office, in your locality is owned by the Post and Telegraph Department, Government of India, though our dependence on their postal services, particularly in cities and towns has been greatly reduced. This is because of plenty of private courier services firms operating in bigger towns. Then there are businesses which operate in more than one country known as global enterprises. Therefore, you may have observed that all types of organisations are doing business in the country whether they are public, private or global. In this chapter we shall be studying how the economy is divided into two sectors, public and private, the different types of public enterprises, their role and that of the global enterprises.

3.2 Private Sector and Public Sector

There are all kinds of business organisations — small or large, industrial or trading, privately owned or government owned existing in our country. These organisations affect our daily economic life and therefore become part of the Indian economy. Since the Indian economy consists of both privately owned and government owned business enterprises, it is known as a mixed economy. The Government of India has opted for a mixed economy where both private and government enterprises are allowed to operate. The economy, therefore, may be classified into two sectors viz., private sector and public sector.

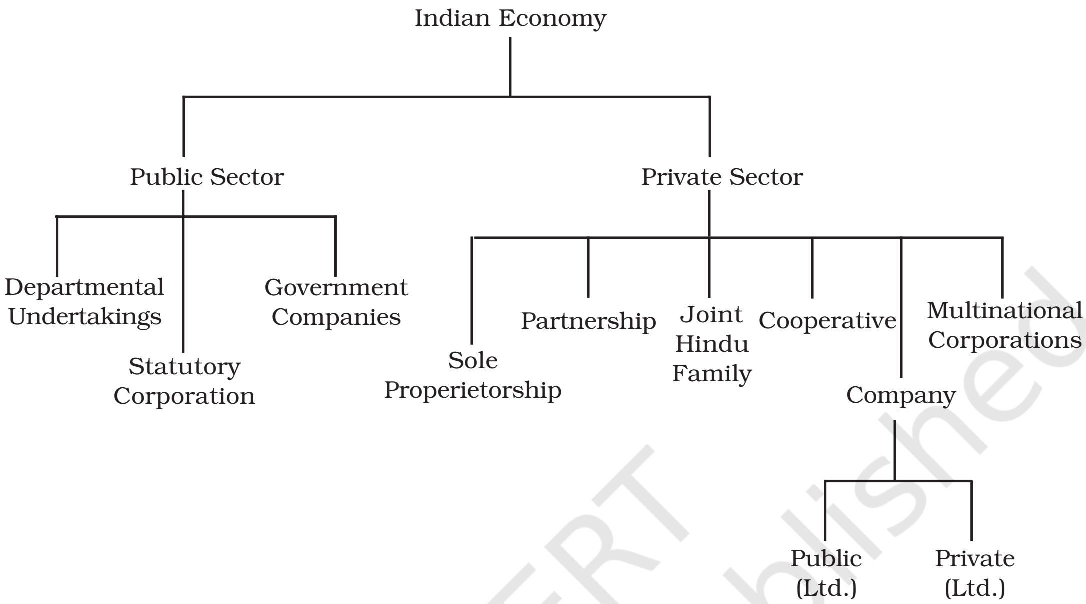
The private sector consists of business owned by individuals or a group of individuals, as you have learnt in the previous chapter. The various forms of organisation are sole proprietorship, partnership, joint Hindu family, cooperative and company.

The public sector consists of various organisations owned and managed by the government. These organisations may either be partly or wholly owned by the central or state government. They may also be a part of the ministry or come into existence by a Special Act of the Parliament. The government, through these enterprises participates in the economic activities of the country.

The government in its industrial policy resolutions, from time-to-time, defines the area of activities in which the private sector and public sector are allowed to operate. In the Industrial Policy Resolution 1948, the Government of India had specified the approach towards development of the industrial sector. The roles of the private and public sector were clearly defined and the government through various Acts and Regulations was overseeing the economic activities of both the private and public sector. The Industrial Policy Resolution, 1956 had also laid down certain objectives for the public sector to follow so as to accelerate the rate of growth and industrialisation. The public sector was given a lot of importance but at the same time mutual dependency of public and private sectors was emphasised. The 1991 industrial policy was radically different from all the earlier policies where the government was deliberating disinvestment of public sector and allowing greater freedom to the private sector. At the same time, foreign direct investment was invited from business houses outside India. Thus, multinational corporations or global enterprises which operate in more than one country gained entry into the Indian economy. Thus, we have public sector units, private sector enterprises and global enterprises coexisting in the Indian economy.

3.3 Forms of Organising Public Sector Enterprises

Government's participation in business and economic sectors of the country needs some kind of organisational framework to function. You have studied about the forms of business organisation in the private sector viz., sole proprietorship, partnership, Hindu undivided family, cooperative and company.



In the public sector, as it grows, an important question arises in respect of how it is to be organised or what form of organisation it should take. The government has a major role to play in the formation of the public sector. But the government acts through its people, its offices, employees and they take decisions on behalf of the government. For this purpose, public enterprises were formed by the government to participate in the economic activities of the country. They are expected to contribute to the economic development of the country in today's liberalised, competitive world. These public enterprises are owned by the public and are accountable to the public through the Parliament. They are characterised by public ownership, public funds being used for its activities and public accountability.

A public enterprise may take any particular form of organisation depending upon the nature of its operations and their relationship with the government. The suitability of a particular form of organisation would depend upon its requirements. At the same time, in accordance with general principles, any organisation in the public sector should ensure organisational performance productivity and quality standards.

The forms of organisation which a public enterprise may take are as follows:

(i) Departmental undertaking
(ii) Statutory corporation
(iii) Government company

3.3.1 Departmental Undertakings

This is the oldest and most traditional form of organising public enterprises.

These enterprises are established as departments of the ministry and are considered part or an extension of the ministry itself. The Government functions through these departments and the activities performed by them are an integral part of the functioning of the government. They have not been constituted as autonomous or independent institutions and as such are not independent legal entities. They act through the officers of the Government and its employees are Government employees. These undertakings may be under the central or the state government and the rules of central/state government are applicable. Examples of these undertakings are railways and post and telegraph department.

Features

The main characteristics of Departmental undertakings are as follows:

(i) The funding of these enterprises come directly from the Government Treasury and are an annual appropriation from the budget of the Government. The revenue earned by these is also paid into the treasury;
(ii) They are subject to accounting and audit controls applicable to other Government activities;
(iii) The employees of the enterprise are Government servants and their recruitment and conditions of service are the same as that of other employees directly under the Government. They are headed by Indian Administrative Service (IAS) officers and civil servants who are transferable from one ministry to another;
(iv) It is generally considered to be a major subdivision of the Government department and is subject to direct control of the ministry;
(v) They are accountable to the ministry since their management is directly under the concerned ministry.

Merits

Departmental undertakings have certain advantages which are as follows:

(i) These undertakings facilitate the Parliament to exercise effective control over their operations;
(ii) These ensure a high degree of public accountability;
(iii) The revenue earned by the enterprise goes directly to the treasury and hence is a source of income for the Government;
(iv) Where national security is concerned, this form is most suitable since it is under the direct control and supervision of the concerned Ministry.

Limitations

This form of organisation suffers from serious drawbacks, some of which are as follows:

(i) Departmental undertakings fail to provide flexibility, which is essential for the smooth operation of business;
(ii) The employees or heads of departments of such undertakings are

not allowed to take independent decisions, without the approval of the ministry concerned. This leads to delays, in matters where prompt decisions are required;

(iii) These enterprises are unable to take advantage of business opportunities. The bureaucrat's over-cautious and conservative approval does not allow them to take risky ventures;

(iv) There is red tapism in day-to-day operations and no action can be taken unless it goes through the proper channels of authority;

(v) There is a lot of political interference through the ministry;

(vi) These organisations are usually insensitive to consumer needs and do not provide adequate services to them.

3.3.2 Statutory Corporations

Statutory corporations are public enterprises brought into existence by a Special Act of the Parliament. The Act defines its powers and functions, rules and regulations governing its employees and its relationship with government departments.

This is a corporate body created by the legislature with defined powers and functions and is financially independent with a clear control over a specified area or a particular type of commercial activity. It is a corporate person and has the capacity of acting in its own name. Statutory corporations therefore have the power of the government and considerable amount of operating flexibility of private enterprises.

Features

Statutory corporations have certain distinct features, which are discussed as below:

(i) Statutory corporations are set up under an Act of Parliament and are governed by the provisions of the Act. The Act defines the objects, powers and privileges of a statutory corporation;

(ii) This type of organisation is wholly owned by the state. The government has the ultimate financial responsibility and has the power to appropriate its profits. At the same time, the state also has to bear the losses, if any;

(iii) A statutory corporation is a body corporate and can sue and be sued, enter into contract and acquire property in its own name;

(iv) This type of enterprise is usually independently financed. It obtains funds by borrowings from the government or from the public through revenues, derived from sale of goods and services. It has the authority to use its revenues;

(v) A statutory corporation is not subject to the same accounting and audit procedures applicable to government departments. It is also not concerned with the central budget of the Government;

(vi) The employees of these enterprises are not government or civil servants and are not governed by government rules and regulations. The conditions of service of the employees are governed by the provisions of the Act itself. At times, some officers are taken from government departments, on deputation, to head these organisations.

Merits

This form of organisation enjoys certain advantages in its working, which are as follows:

(i) They enjoy independence in their functioning and a high degree of operational flexibility. They are free from undesirable government regulation and control;

(ii) Since the funds of these organisations do not come from the central budget, the government generally does not interfere in their financial matters, including their income and receipts;

(iii) Since they are autonomous organisations they frame their own policies and procedures within the powers assigned to them by the Act. The Act may, however, provide few issues/matters which require prior approval of a particular ministry;

(iv) A statutory corporation is a valuable instrument for economic development. It has the power of the government, combined with the initiative of private enterprises.

Limitations

This type of organisation suffers from several limitations, which are as follows:

(i) In reality, a statutory corporation does not enjoy as much operational flexibility as stated above. All actions are subject to many rules and regulations;

(ii) Government and political interference has always been there in major decisions or where huge funds are involved;

(iii) Where there is dealing with public, rampant corruption exists;

(iv) The Government has a practice of appointing advisors to the Corporation Board. This curbs the freedom of the corporation in entering into contracts and other decisions. If there is any disagreement, the matter is referred to the government for final decisions. This further delays action.

3.3.3 Government Company

A government company is established under The Companies Act, 2013 and is registered and governed by the provisions of The Act. These are established for purely business purposes and in true spirit compete with companies in the private sector.

According to the section 2(45) of the Companies Act 2013, a government company means any company in which not less than 51 per cent of the paid up capital is held by the central government, or by any state government or partly by Central government and partly by one or more State governments and includes a company which is a subsidiary of a government company. Under the Companies Act 2013, there is no change in the definition of a company. All provisions of the Act are applicable to government companies unless otherwise specified. A government company may be formed as a private limited company or a public limited company. There are certain provisions which are applicable to the appointment/retirement of directors and other managerial personnel.

From the above it is clear that the government exercises control over the paid up share capital of the company. The shares of the company are purchased in the name of the President of India. Since the government is the major shareholder and exercises control over the management of these companies, they are known as government companies.

Features

Government companies have certain characteristics which makes them distinct from other forms of organisations. These are discussed as follows:

(i) It is an organisation created under the Companies Act, 2013 or any other previous Company Law.

(ii) The company can file a suit in a court of law against any third party and be sued;

(iii) The company can enter into a contract and can acquire property in its own name;

(iv) The management of the company is regulated by the provisions of the Companies Act, like any other public limited company;

(v) The employees of the company are appointed according to their own rules and regulations as contained in the Memorandum and Articles of Association of the company. The Memorandum and Articles of Association are the main documents of the company, containing the objects of the company and its rules and regulations;

(vi) These companies are exempted from the accounting and audit rules and procedures. An auditor is appointed by the Central Government and the Annual Report is to be presented in the Parliament or the State Legislature;

(vii) The government company obtains its funds from government shareholdings and other private shareholders. It is also permitted to raise funds from the capital market.

Merits

Government companies enjoy several advantages, which are as follows:

(i) A government company can be established by fulfilling the requirements of the Indian Companies Act. A separate Act in the Parliament is not required;

(ii) It has a separate legal entity, apart from the Government;

(iii) It enjoys autonomy in all management decisions and takes actions according to business prudence;

(iv) These companies by providing goods and services at reasonable prices are able to control the market and curb unhealthy business practices.

Limitations

Despite the autonomy given to these companies, they have certain disadvantages:

(i) Since the Government is the only shareholder in some of the companies, the provisions of the Companies Act does not have much relevance;

(ii) It evades constitutional responsibility, which a company financed by the government should have. It is not answerable directly to the Parliament;

(iii) The government being the sole shareholder, the management and administration rests in the hands of the government. The main purpose of a government company, registered like other companies, is defeated.

3.4 Changing Role of Public Sector

At the time of Independence, it was expected that the public sector enterprises would play an important role in achieving certain objectives of the economy either by direct participation in business or by acting as a catalyst. The public sector would build up infrastructure for other sectors of the economy and invest in key areas. The private sector was unwilling to invest in projects which required heavy investment and had long gestation periods. The government then took it upon itself to develop infrastructural facilities and provide for goods and services essential for the economy.

The Indian economy is in a stage of transition. The Five Year Plans in the initial stages of development gave lot of importance to the public sector. In the post–1990s, the new economic policies, emphasised on liberalisation, privatisation and globalisation. The role of public sector was redefined. It was not supposed to play a passive role but to actively participate and compete in the market with other private sector companies in the same industry. They were also held accountable for losses and return on investment. If a public sector was making losses continuously, it was referred to the Board for Industrial and Financial Reconstruction (BIFR) for complete overhauling or shut down. Various committees were set up to study the working of inefficient public sector units with reports on how to improve their managerial efficiency and profitability. The role of public sector is definitely not what was envisaged in the early 1960s or 70s.

(i) Development of infrastructure: The development of infrastructure is a prerequisite for industrialisation in any country. In the pre-Independence period, basic infrastructure was not developed and therefore, industrialisation progressed at a very slow pace. The process of industrialisation cannot be sustained without adequate transportation and communication facilities, fuel and energy, and basic and heavy industries. The private sector did not show any initiative to invest in heavy industries or develop it in any manner. They did not have trained personnel or finances to immediately establish heavy industries which was the requirement of the economy.

It was only the government which could mobilise huge capital, coordinate industrial construction and train technicians and workforce. Rail, road, sea and air transport was the responsibility of the government, and their expansion has contributed to the pace of industrialisation and ensured future economic growth. The public sector enterprises were to operate in certain spheres. Investments were to be made to:

(a) Give infrastructure to the core sector, which requires huge capital investment, complex and upgraded technology, big and effective organisation structures like steel plants, power generation plants, civil aviation, railways, petroleum, state trading, coal, etc;
(b) Give a lead in investment to the core sector where private sector enterprises are not functioning in the desired direction, like fertilizers, pharmaceuticals, petro-chemicals, newsprint, medium and heavy engineering;
(c) Give direction to future investments like hotels, project management, consultancies, textiles, automobiles, etc.

(ii) Regional balance: The government is responsible for developing all regions and states in a balanced way and removing regional disparties. Most of the industrial progress was limited to a few areas like the port towns in the pre-Independence period. After 1951, the government laid down in its Five Year Plans, that particular attention would be paid to those regions which were lagging behind and public sector industries were deliberately set up. Four major steel plants were set up in the backward areas to accelerate economic development, provide employment to the workforce and develop ancilliary industries. This was achieved to some extent but there is scope for a lot more. Development of backward regions so as to ensure a regional balance in the country is one of the major objectives of planned development. Therefore, the government had to locate new enterprises in backward areas and at the same time prevent the mushrooming growth of private sector units in already advanced areas.

(iii) Economies of scale: Where large scale industries are required to be set up with huge capital outlay, the public sector had to step in to take advantage of economies of scale. Electric power plants, natural gas, petroleum and telephone industries are some examples of the public sector setting up large scale units. These units required a larger base to function economically which was only possible with government resources and mass scale production.

(iv) Check over concentration of economic power: The public sector acts as a check over the private sector. In the private sector there are very few industrial houses which would be willing to invest in heavy industries with the result that wealth gets concentrated in a few hands and monopolostic practices are encouraged. This gives rise to inequalities in income, which is detrimental to society.

The public sector is able to set large industries which requires heavy investment and thus the income and benefits that accrue are shared by a large of number of employees and workers. This prevents concentration of wealth and economic power in the private sector.

(v) Import substitution: During the second and third Five Year Plan period, India was aiming to be self-reliant in many spheres. Obtaining foreign exchange was also a problem and it was difficult to import heavy machinery required for a strong industrial base. At that time, public sector companies involved in heavy engineering which would help in import substitution were established. Simultaneously, several public sector companies like STC and MMTC have played an important role in expanding exports of the country.

(vi) Government policy towards the public sector since 1991: The Government of India had introduced four major reforms in the public sector in its new industrial policy in 1991. The main elements of the Government policy are as follows:

- Restructure and revive potentially viable PSUs
- Close down PSUs, which cannot be revived
- Bring down governments equity in all non-strategic PSUs to 26 per cent or lower, if necessary; and
- Fully protect the interest of workers

(a) Reduction in the number of industries reserved for the public sector from 17 to 8 (and then to 3): In the 1956 resolution on Industrial policy, 17 industries were reserved for the public sector. In 1991, only 8 industries were reserved for the public sector, they were restricted to atomic energy, arms and communication, mining, and railways. In 2001, only three industries were reserved exclusively for the public sector. These are atomic energy, arms and rail transport. This meant that the private sector could enter all areas (except the three) and the public sector would have to compete with them.

The public sector has played a vital role in the development of the economy. However, the private sector is also quite capable of contributing substantially to the nation building process. Therefore, both the public sector and the private sector need to be viewed as mutually complementary parts of the national sector. Private sector units also have to assume greater public responsibilities. Simultaneously, the public sector needs to focus on achieving more in a highly competitive market.

(b) Disinvestment of shares of a select set of public sector enterprises: Disinvestment involves the sale of the equity shares to the private sector and the public. The objective was to raise resources and encourage wider participation of the general public and workers in the ownership of these enterprises. The government had taken a decision to withdraw from the industrial sector and reduce its equity in all undertakings. It was expected that this would lead to improving managerial performance and ensuring financial discipline. But there remains a lot to be done in this area.

The primary objectives of privatising public sector enterprises are:

- Releasing the large amount of public resources locked up in non-strategic Public Sector Enterprises (PSEs), so that they may be utilised on other social priority areas such as basic health, family welfare and primary education.
- Reducing the huge amount of public debt and interest burden;
- Transferring the commercial risk to the private sector so that the funds are invested in able projects;
- Freeing these enterprises from government control and introduction of corporate governance; and
- In many areas where the public sector had a monopoly, for example, telecom sector the consumers have benefitted by more choices, lower prices and better quality of products and services.

(c) Policy regarding sick units to be the same as that for the private sector: All public sector units were referred to the Board of Industrial and Financial Reconstruction to decide whether a sick unit was to be restructured or closed down. The Board has reconsidered revival and rehabilitation schemes for some cases and winding up for a number of units. There is a lot of resentment amongst workers of the units which are to be closed down. A National Renewal Fund was set up by the government to retrain or redeploy retrenched labour and to provide compensation to public sector employees seeking voluntary retirement.

There are many enterprises which are sick and not capable of being revived as they have accumulated huge losses. With public finances under intense pressure, both central and state government are just not able to sustain them much longer. The only option available to the government in such cases is to close down these undertakings after providing a safety net for the employees and workers. Resources under the National Renewal Fund have not been sufficient to meet the cost of Voluntary Separation Scheme or Voluntary Retirement Scheme.

(d) Memorandum of Understanding: Improvement of performance through a MoU (Memorandum of Understanding) system by which managements are to be granted greater autonomy but held accountable for specified results. Under this system, public sector units were given clear targets and operational autonomy for achieving those targets. The MoU was between the particular public sector unit and their administrative ministries defining their relationship and autonomy.

3.5 Global Enterprises

At some time you must have come across products produced by Multi National Corporations (MNCs). In the last ten years MNCs have played an important role in the Indian economy. They have become a common feature of most developing economies in the world. MNCs as is evident from what we see around us, are gigantic corporations which have their operations in a number of countries. They are characterised by their huge size, large number of products, advanced technology, marketing strategies and network of operations all over the world. Global enterprises thus are huge industrial organisations which extend their industrial and marketing operations through a network of their branches in several countries. Their branches are also called Majority Owned Foreign Affiliates (MOFA). These enterprises operate in several areas producing multiple products with their business strategy extending over a number of countries. They do not aim at maximising profits from one or two products but instead spread their branches all over. They have an impact on the international economy also. This is evident from the fact that the sales of top 200 corporations were equivalent to 28.3 percent of the world's GDP in 1998. This shows that top 200 MNCs control over a quarter of the world economy. Therefore, MNCs are in a position to exercise massive control on the world economy because of their capital resources, latest technology and goodwill. By virtue of this, they are able to sell any product in different countries. Some of these corporations may be slightly exploitative in nature and concentrate more on selling consumer goods and luxury items which are not always desirable for developing countries.

Features

These corporations have distinct features which distinguish them from other private sector companies, public sector companies and public sector enterprises. These are as follows:

(i) Huge capital resources: These enterprises are characterised by possessing huge financial resources and the ability to raise funds from different sources. They are able to tap funds from various sources. They may issue equity shares, debentures or bonds to the public. They are also in a position to borrow from financial institutions and international banks. They enjoy credibility in the capital market. Even investors and banks of the host country are willing to invest in them. Because of their financial strength they are able to survive under all circumstances.

(ii) Foreign collaboration: Global enterprises usually enter into agreements with Indian companies pertaining to the sale of technology, production of goods, use of brand names for the final products, etc. These MNCs may collaborate with companies in the public and private sector. There are usually various restrictive clauses in the agreement relating to transfer of technology, pricing, dividend payments, tight control by foreign technicians, etc. Big industrial houses wanting to diversify and expand have gained by collaborating with MNCs in terms of patents, resources, foreign exchange etc. But at the same time these foreign collaborations have given rise to the growth of monopolies and concentration of power in few hands.

(iii) Advanced technology: These enterprises possess technological superiorities in their methods of production. They are able to conform to international standards and quality specifications. This leads to industrial progress of the country in which such corporations operate since they are able to optimally exploit local resources and raw materials. Computerisation and other inventions have come due to the technological advancements provided by MNCs.

(iv) Product innovation: These enterprises are characterised by having highly sophisticated research and development departments engaged in the task of developing new products and superior designs of existing products. Qualitative research requires huge investment which only global enterprises can afford.

(v) Marketing strategies: The marketing strategies of global companies are far more effective than other companies. They use aggressive marketing strategies in order to increase their sales in a short period. They posses a more reliable and up-to-date market information system. Their advertising and sales promotion techniques are normally very effective. Since they already have carved out a place for themselves in the global market, and their brands are well-known, selling their products is not a problem.

(vi) Expansion of market territory: Their operations and activities extend beyond the physical boundaries of their own countries. Their international image also builds up and their market territory expands enabling them to become international brands. They operate through a network of subsidiaries, branches and affiliates in host countries. Due to their giant size they occupy a dominant position in the market.

(vii) Centralised control: They have their headquaters in their home country and exercise control over all branches and subsidiaries. However, this control is limited to the broad policy framework of the parent company. There is no interference in day-to-day operations.

3.6 Joint Ventures

Meaning

Business organisations as you have studied earlier can be of various types private or government owned or global enterprises. Now, any business organisation if it so desires can join hands with another business organisation for mutual benefit. These two organisations may be private, government-owned or a foreign company. When two businesses agree to join together for a common purpose and mutual benefit, it gives rise to a joint venture. Businesses of any size can use joint ventures to strengthen long-term relationships or to collaborate on short term projects. A joint venture can be flexible depending upon the party's requirements. These need to be clearly stated in a joint venture agreement to avoid conflict at a later stage.

A joint venture may also be the result of an agreement between two businesses in different countries. In this case, there are certain provisions provided by the governments of the two countries, which will have to be adhered to.

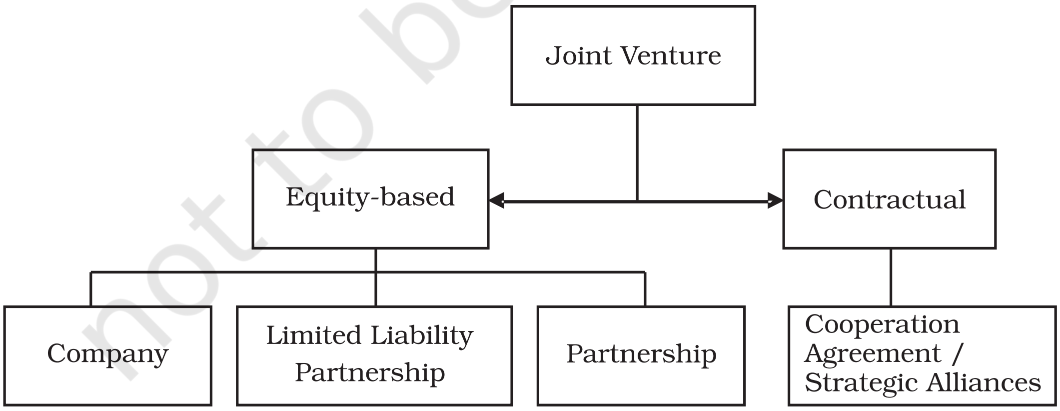
Thus, we see that joint ventures may mean many things, depending upon the context we are using it in. But in a broader sense, a joint venture is the pooling of resources and expertise by two or more businesses, to achieve a particular goal. The risks and rewards of the business are also shared. The reasons behind the joint venture often include business expansion, development of new products or moving into new markets, particularly in another country. It is becoming increasingly common for companies to create joint ventures with other businesses/companies and form strategic alliances with them. The reasons for these alliances may be complementary capabilities and resources such as distribution channels, technology or finance. In this kind of a joint venture, two or more (parent) companies agree to share capital, technology, human resources, risks and rewards in the formation of a new entity, under shared control.

In India, joint venture companies are the best way of doing business. There are no separate laws for these joint ventures. The companies incorporated in India are treated the same as domestic companies.

Joint Ventures are of two types —

Contractual joint venture

Equity-based joint venture



3.6.1 Types of Joint Ventures

(i) Contractual Joint Venture (CJV): In a contractual joint venture, a new jointly-owned entity is not created. There is only an agreement to work together. The parties do not share ownership of the business but exercise some elements of control in the joint venture. A typical example of a contractual joint venture is a franchisee relationship. In such a relationship the key elements are:

(a) Two or more parties have a common intention – of running a business venture;
(b) Each party brings some inputs;
(c) Both parties exercise some control on the business venture; and
(d) The relationship is not a transaction-to-transaction relationship but has a character of relatively longer duration.

(ii) Equity-based Joint Venture (EJV): An equity joint venture agreement is one in which a separate business entity, jointly owned by two or more parties, is formed in accordance with the agreement of the parties. The key operative factor in such case is joint ownership by two or more parties. The form of business entity may vary — company, partnership firm, trusts, limited liability partnership firms, venture capital funds, etc.

(a) There is an agreement to either create a new entity or for one of the parties to join into ownership of an existing entity;
(b) Shared ownership by the parties involved;
(c) Shared management of the jointly owned entity;
(d) Shared responsibilities regarding capital investment and other financing arrangements; and
(e) Shared profits and losses according to the agreement.

A joint venture must be based on a memorandum of understanding signed by both the parties, highlighting the basis of a joint venture agreement. The terms should be thoroughly discussed and negotiated to avoid any legal complications at a later stage. Negotiations and terms must take into account the cultural and legal background of the parties. The joint venture agreement must also state that all necessary governmental approvals and licences will be obtained within a specified period.

Examples of Joint Ventures:

1. AVI Oil India Pvt. Ltd.
   Date of establishment: 4 November, 1993
   Joint Venture Holders: Balmer Lawrie & Co. Ltd., NYCO SA, France.
   Areas of operation: Mineral-based lubricating oil, defence and civil aviation uses, greases.
2. Green Gas Ltd.
   Date of establishment: 7 October, 2005
   Joint Venture Holders: GAIL (India) Ltd. and IOCL

Areas of operations: Providing safe and reliable natural gas to customers.

3. Delhi Aviation Fuel Facility Pvt. Ltd.
   Date of establishment: 28 March, 2010
   Joint Venture Holders: BPCL and DIAL
   Areas of operations: Construction, management, maintenance, developing, designing. The company is formed with a joint venture between Delhi International Airport Ltd. and Airport Authority of India with the view of maintenance, designing and modernisation.

3.6.2 Benefits

Business can achieve unexpected gains through joint ventures with a partner. Joint ventures can prove to be extremely beneficial for both parties involved. One party may have strong potential for growth and innovative ideas, but is still likely to benefit from entering into a joint venture because it enhances its capacity, resources and technical expertise. The major benefits of joint ventures are as follows:

(i) Increased resources and capacity: Joining hands with another or teaming up adds to existing resources and capacity enabling the joint venture company to grow and expand more quickly and efficiently. The new business pools in financial and human resources and is able to face market challenges and take advantage of new opportunities.

(ii) Access to new markets and distribution networks: When a business enters into a joint venture with a partner from another country, it opens up a vast growing market. For example, when foreign companies form joint venture companies in India they gain access to the vast Indian market. Their products which have reached saturation point in their home markets can be easily sold in new markets.

They can also take advantage of the established distribution channels i.e., the retail outlets in different local markets. Otherwise, establishing their own retail outlets may prove to be very expensive.

(iii) Access to technology: Technology is a major factor for most businesses to enter into joint ventures. Advanced techniques of production leading to superior quality products saves a lot of time, energy and investment as they do not have to develop their own technology. Technology also adds to efficiency and effectiveness, thus leading to reduction in costs.

(iv) Innovation: The markets are increasingly becoming more demanding in terms of new and innovative products. Joint ventures allow business to come up with something new and creative for the same market. Specially foreign partners can come up with innovative products because of new ideas and technology.

(v) Low cost of production: When international corporations invest in India, they benefit immensely due to the lower cost of production. They are able to get quality products for their global requirements. India is becoming an important global source and extremely competitive in many products.

There are many reasons for this, low cost of raw materials and labour, technically qualified workforce; management professionals, excellent manpower in different cadres, like lawyers, chartered accountants, engineers, scientists. The international partner thus, gets the products of required quality and specifications at a much lower cost than what is prevailing in the home country.

(vi) Established brand name: When two businesses enter into a joint venture, one of the parties benefits from the other's goodwill which has already been established in the market. If the joint venture is in India and with an Indian company, the Indian company does not have to spend time or money in developing a brand name for the product or even a distribution system. There is a ready market waiting for the product to be launched. A lot of investment is saved in the process.

3.7 Public Private Partnership (PPP)

The Public Private Partnership model allocates tasks, obligations and risks among the public and private partners in an optimal manner. The public partners in PPP are Government entities, i.e., ministries, government departments, municipalities or state-owned enterprises. The private partners can be local or foreign (international) and include businesses or investors with technical or financial expertise relevant to the project. PPP also includes NGOs and/or community-based organisations who are the stakeholders directly affected by the project. PPP is, therefore, defined as a relationship between public and private entities in the context of infrastructure and other services. Under the PPP model, public sector plays an important role and ensures that the social obligations are fulfilled and sector reforms and public investment are successfully met. The government's contribution to PPP is in the form of capital for investment and transfer of assets that support the partnership in addition to social responsibility, environmental awareness and local knowledge. The private sector's role in the partnership is to make use of its expertise in operations, managing tasks and innovation to run the business efficiently.

Sectors in which PPPs have been completed worldwide include power generation and distribution, water and sanitation, refuse disposal, pipelines, hospitals, school buildings and teaching facilities, stadiums, air traffic control, prisons, railways, roads, billing and other information technology systems, and housing.

PPP Model

Features
- Contract with the private party to design and build public facility.
- Facility is financed and owned by the public sector.
- Key driver is the transfer of design and construction risk.

Application
- Suited to capital projects with small operating requirement.
- Suited to capital projects where the public sector wishes to retain the operating responsibility.

Strengths
- Transfer of design and construction risk.
- Potential to accelerate project.

Weaknesses
- Conflict between parties may arise on environmental considerations
- Does not attract private finance easily.

Example
- Kundli Manesar Expressway Ltd.: In this 135 km expressway, land has been provided by the government and surface has been laid out by the company.

Key Terms

Public sector	Departmental undertaking	Globalisation
Public enterprises	Government companies	Global enterprises
Statutory corporation	Disinvestment	Public Sector Undertakings
Joint ventures	Public accountability	
Public Private Partnership	Privatisation	

SUMMARY

Private sector and public sector: There are all kinds of business organisations — small or large, industrial or trading, privately owned or government owned existing in our country. These organisations affect our daily economic life and therefore, become part of the Indian economy. The Government of India has opted for a mixed economy, where both private and government enterprises are allowed to operate. The economy, therefore, may be classified into two sectors viz., private sector and public sector. The private sector consists of business owned by individuals or a group of individuals. Various forms of organisation are sole proprietorship, partnership, joint Hindu family, cooperative and company. The public sector consists of various organisations owned and managed by the government. These organisations may either be partly or wholly owned by the Central or State government.

Forms of organising public sector enterprises: Government's participation in business and economic sectors of the country needs some kind of organisational framework to function. A public enterprise may take any particular form of organisation depending upon the nature of it's operations and their relationship with the government. The suitability of a particular form of organisation would depend upon its requirements. The forms of organisation which a public enterprise may take are as follows:

(i) Departmental undertaking
(ii) Statutory corporation
(iii) Government company

Departmental undertakings: These enterprises are established as departments of the ministry and are considered part or an extension of the ministry itself. The Government functions through these departments and the activities performed by them are an integral part of the functioning of the government.

Statutory corporations: Statutory corporations are public enterprises brought into existence by a Special Act of the Parliament. The Act defines its powers and functions, rules and regulations governing its employees and its relationship with Government departments. This is a corporate body created by legislature with defined powers and functions and financially independent with a clear control over a specified area or a particular type of commercial activity.

Government company: A Government company means any company in which not less than 51 percent of the paid up capital is held by the central government, or by any state governments or government or partly by central government and partly by one or more state governments and includes a company which is a subsidiary company of such a government company.

Changing role of public sector: At the time of Independence, it was expected that the public sector enterprises would play an important role in achieving certain objectives of the economy either by direct participation in business or by acting as a catalyst. The Indian economy is in a stage of transition. In the post 90's period, the new economic policies emphasised liberalisation, privatisation and globalisation. The role of the public sector was redefined. It was not supposed to play a passive role but to actively participate and compete in the market with other private sector companies in the same industry.

Development of infrastructure: The process of industrialisation cannot be sustained without adequate transportation and communication facilities, fuel and energy, and basic and heavy industries. It is only the government which could mobilise huge capital, coordinate industrial construction and train technicians and workforce.

Regional balance: The government is responsible for developing all regions and states in a balanced way and removing regional disparties. Development of backward regions so as to ensure a regional balance in the country is one of the major objectives of planned development. Therefore, the government had to locate new enterprises in backward areas and at the same time prevent the mushrooming growth of private sector unit in already advanced areas.

Economies of scale: Where large scale industries are required to be set up with huge capital outlay, the public sector had to step in to take advantage of economies of scale.

Check over concentration of economic power: The public sector acts as a check over the private sector. In the private sector there are very few industrial houses which would be willing to invest in heavy industries with the result that wealth gets concentrated in a few hands and monopolostic practices are encouraged.

Import substitution: During the second and third Five Year Plan period, India was aiming to be self-reliant in many spheres. Public sector companies involved in heavy engineering which would help in import substitution were established.

Government policy towards public sector since 1991. Its main elements are: Restructure and revive potentially viable PSUs, Close down PSUs, which cannot be revived. Bring down governments equity in all non-strategic PSUs to 26 per cent or lower if necessary; and fully protect the interest of workers.

(a) *Reduction in the number of industries reserved for the public sector from 17 to 8 (and then to 3)*: This meant that the private sector could enter all areas (except 3) and the public sector would have to compete with them.

(b) *Disinvestment of shares of a select set of public sector enterprises:* Disinvestment involves the sale of the equity shares to the private sector and the public. The objective was to raise resources and encourage wider participation of the general public and workers in the ownership of these enterprises. The government had taken a decision to withdraw from the industrial sector and reduce its equity in all undertakings.

(c) *Policy regarding sick units to be the same as that for the private sector:* All public sector units were referred to the Board of Industrial and Financial Reconstruction to decide whether a sick unit was to be restructured or closed down.

Memorandum of Understanding: Improvement of performance through a MoU (Memorandum of Understanding) system by which managements are to be granted greater autonomy but held accountable for specified results.

Global enterprises: In the last ten years MNCs have played an important role in the Indian economy. They are characterised by their huge size, large number of products, advanced technology, marketing strategies and network of operations all over the world. Global enterprises thus are huge industrial organisations which extend their industrial and marketing operations through a network of their branches in several countries.

Features: These corporations have distinct features which distinguishes them from other private sector companies, public sector companies and public sector enterprises i.e., (i) Huge capital resources, (ii) Foreign collaboration, (iii) Advanced Technology, (iv) Product innovation, (v) Marketing strategies, (vi) Expansion of market territory, (vii) Centralised control.

Joint ventures: Joint ventures may mean many things, depending upon the context we are using it in. But in a broader sense, a joint venture is the pooling of resources and expertise by two or more businesses, to achieve a particular goal. The risks and rewards of the business are also shared. The reasons behind the joint venture often include business expansion, development of new products or moving into new markets, particularly in another country.

Benefits: Business can achieve unexpected gains through joint ventures with a partner. The major benefits of joint venture are as follows: (i) Increased resources and capacity (ii) Access to new markets and distribution networks (iii) Access to technology (iv) Innovation (v) Low cost of production (vi) Established brand name.

Public Private Partnership: It is a relationship among public sector and private sector for allocation and completion of development projects.

EXERCISES

Multiple Type Questions

1. A government company is any company in which the paid up capital held by the government is not less than
   (a) 49 per cent (b) 51 per cent
   (c) 50 per cent (d) 25 per cent
2. Centralised control in MNC's implies control exercised by
   (a) Branches (b) Subsidiaries
   (c) Headquarters (d) Parliament
3. PSE's are organisations owned by
   (a) Joint Hindu family (b) Government
   (c) Foreign Companies (d) Private entrepreneurs
4. Reconstruction of sick public sector units is taken up by
   (a) MOFA (b) MoU
   (c) BIFR (d) NRF

5. Disinvestments of PSE's implies
   (a) Sale of equity shares to private sector/public
   (b) Closing down operations
   (c) Investing in new areas
   (d) Buying shares PSE's

6. The equity-based joint venture does not include
   (a) Cooperative development
   (b) Company
   (c) Partnership
   (d) Limited liability partnership

Short Answer Questions

1. Explain the concept of public sector and private sector.
2. State the various types of organisations in the private sector.
3. What are the different kinds of organisations that come under the public sector?
4. List the names of some enterprises under the public sector and classify them.
5. Why is the government company form of organisation preferred to other types in the public sector?
6. How does the government maintain a regional balance in the country?
7. State the meaning of public private partnership.

Long Answer Questions

1. Describe the Industrial Policy 1991, towards the public sector.
2. What was the role of the public sector before 1991?
3. Can the public sector companies compete with the private sector in terms of profits and efficiency? Give reasons for your answer.
4. Why are global enterprises considered superior to other business organisations?
5. What are the benefits of entering into joint ventures and public private partnership?

Projects/Assignments

1. Make a list of Indian companies entering into joint ventures with foreign companies. Find out the apparent benefits derived out of such ventures.

Chapter 4

Business Services

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- state the characteristics of services;
- distinguish services from goods;
- classify different types of business services;
- explain the concept of e-banking;
- identify and classify different types of insurance policies; and
- describe different types of warehouses.

All of us have seen a petrol pump. Have your ever thought how a petrol pump owner does his business in a village? How he gets the petrol and diesel to the villages in the interior? How he gets the money to purchase large quantities of petrol and diesel? How he communicates to petrol depots for requirement and also to customers? How he safeguards himself from various risks associated with this business? The answer to all the above questions lies in the understanding of business services. The transportation of petrol and diesel from oil refineries to petrol pumps is carried out by train and tankers (transport services). They are then stored at various depots of oil companies situated in all major towns across India (warehousing services). Petrol pump owners use postal, mail and telephone facilities to be in touch with customers, banks and the depots for the availability of their requirements on regular basis (communication services). As oil companies always sell the petrol and diesel on advance payment, the owners have to take loans and advances from banks to fund their purchases (banking services). Petrol and diesel being highly risky products, the owners have to safeguard themselves from various risks by getting the business, the products, the life of people working there, etc., insure (insurance services). Thus, we see that a single business of providing petrol and diesel at a petrol pump is actually a collective outcome of various business services. These services are being utilised in the entire process of shipment of petrol and diesel from oil refineries to the point of sale at petrol pumps, spread across the length and breath of India.

4.1 Introduction

You must all have, at some time or the other experienced the effect of business activities on your lives. Let us examine few examples of business activity i.e., purchasing ice cream from a store and eating ice cream in a restaurant, watching a movie in a cinema hall or purchasing a video cassette/CD, purchasing a school bus and leasing it from a transporter. If you analyse all these activities, you will observe that there is a difference between purchasing and eating, purchasing and watching and purchasing and leasing. What is common in all of them is that one is purchasing an item and the other is experiencing a service. But there is definitely a difference between the item or good and the service performed.

For a layperson, services are essentially intangibles. Their purchase does not result in the ownership of anything physical. For example, you can only seek advice from the doctor, you cannot purchase him. Services are all those economic activities that are intangible and imply an interaction to be realised between the service provider and the consumer.

Services are those separately identifiable, essentially intangible activities that provides satisfaction of wants, and are not necessarily linked to the sale of a product or another service.

A good is a physical product capable of being delivered to a purchaser and involves the transfer of ownership from seller to customer. Goods are also generally used to refer to commodities or items of all types, except services, involved in trade or commerce.

4.2 Nature of Services

There are five basic features of services. These features also distinguish them from goods and are known as the five Is of services. These are discussed as below:

(i) Intangibility: Services are intangible, i.e., they cannot be touched. They are experiential in nature. One cannot taste a doctor's treatment, or touch entertainment. One can only experience it. An important implication of this is that quality of the offer can often not be determined before consumption and, therefore, purchase. It is, therefore, important for the service providers that they consciously work on creating a desired service so that the customer undergoes a favourable experience. For example, treatment by a doctor should be a favourable experience.

(ii) Inconsistency: The second important characteristic of services is inconsistency. Since there is no standard tangible product, services have to be performed exclusively each time. Different customers have different demands and expectations. Service providers need to have an opportunity to alter their offer to closely meet the requirements of the customers. This is happening, for example, in the case of mobile services.

(iii) Inseparability: Another important characteristic of services is the simultaneous activity of production and consumption being performed. This makes the production and consumption of services seem to be inseparable. While we can manufacture a car today and sell it after, say, a month; this is often not possible with services that have to be consumed as and when they are produced. Service providers may design a substitute for the person by using appropriate technology but the interaction with the customer remains a key feature of services. Automated Teller Machines (ATMs) may replace the banking clerk for the front office activities like cash withdrawal and cheque deposit. But, at the same time, the presence of the customer, is required and his/her interaction with the process has to be managed.

(iv) Inventory (Less): Services have little or no tangible components and, therefore, cannot be stored for a future use. That is, services are perishable and providers can, at best, store some associated goods but not the service itself. This means that the demand and supply needs to be managed as the service has to be performed as and when the customer asks for it. They cannot be performed earlier to be consumed at a later date. For example, a railway ticket can be stored but the railway journey will be experienced only when the railways provides it.

(v) Involvement: One of the most important characteristics of services is the participation of the customer in the service delivery process. A customer has the opportunity to get the services modified according to specific requirements.

4.2.1 Difference between Services and Goods

From the above, it is clear that the two main differentiating characteristics of services and goods are non-transferability of ownership and presence of both provider as well as consumer. While goods are produced, services are performed. A service is an act which cannot be taken home. What we can take home is the effect of the services. And as the services are sold at the consumption point, there are no inventories. On the basis of above features, we can have following points of distinction between goods and services.

4.3 Types of Services

When speaking of the service sector, services can be classified into three broad categories, viz., business services, social services and personal services. These have been explained in the following pages.

(i) Business Services: Business services are those services which are used by business enterprises for the conduct of their activities. For example, banking, insurance, transportation, warehousing and communication services.

Difference between Services and Goods

Basis	Services	Goods
Nature	An activity or process. e.g., watching a movie in a cinema hall	A physical object. e.g., video cassette of movie
Type	Heterogeneous	Homogenous
Intangibility	Intangible e.g., doctor treatment	Tangible e.g., medicine
Inconsistency	Different customers having different demands e.g., mobile services	Different customers getting standardised demands fulfilled. e.g., mobile phones
Inseparability	Simultaneous production and consumption. e.g., eating ice-cream in a restaurant	Separation of production and consumption. e.g., purchasing ice cream from a store
Inventory	Cannot be kept in stock. e.g., experience of a train journey	Can be kept in stock. e.g., train journey ticket
Involvement	Participation of customers at the time of service delivery. e.g., self-service in a fast food joint	Involvement at the time of delivery not possible. e.g., manufacturing a vehicle

(ii) Social Services: Social services are those services that are generally provided voluntarily in pursuit of certain social goals. These social goals may be to improve the standard of living for weaker sections of society, to provide educational services to their children, or to provide health care and hygienic conditions in slum areas. These services are usually provided voluntarily but for some consideration to cover their costs. For example, health care and education services provided by certain Non-government organisations (NGOs) and government agencies.

(iii) Personal Services: Personal services are those services which are experienced differently by different customers. These services cannot be consistent in nature. They will differ depending upon the service provider. They will also depend upon customer's preferences and demands. For example, tourism, recreational services, restaurants.

In the context of better understanding of the business world, we will be limiting our further discussions to the first category of the service sector i.e., business services.

4.3.1 Business Services

Today's world is of tough competition, where the survival of the fittest is the rule. There is no room for non-performance, and hence companies tend to stick to what they can do best. In order to be competitive, business enterprises, are becoming more and more dependant on specialised business services. Business enterprises look towards banks for availability of funds; insurance companies for getting their plant, machinery, goods, etc., insured; transport companies for transporting raw material; and finished goods, and telecom and postal services for being in touch with their vendors, suppliers and customers. Today's globalised world has ushered in a rapid change in the service industry in India. India has been gaining a highly competitive edge over other countries when it comes to providing services to the developed economies of the world. Many foreign companies are looking to India for performing a host of business services. They are even transferring a part of their business operations to be performed in India. We will discuss these in detail in the next chapter.

4.4 Banking

Commercial banks are an important institution of the economy for providing institutional credit to its customers. A banking company in India is the one which transacts the business of banking which means accepting, for the purpose of lending and investment of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheques, draft, order or otherwise. In simple terms, a bank accepts money on deposits, repayable on demand and also earns a margin of profit by lending money. A bank stimulates economic activity in the market by dealing in money. It mobilises the savings of people and makes funds available to business financing their capital and revenue expenditure. It also deals in financial instruments and provides financial services for a price, i.e., interest, discount, commission, etc.

Banking and Social Objectives

In the recent past there has been a concerted effort by the policy makers in reorienting banking towards achieving social objectives. There has been a major shift in the banking policy of the country:

	from		to
(i)	Urban orientation	—	Rural orientation
(ii)	Class banking	—	Mass banking
(iii)	Traditional	—	Innovative practices
(iv)	Short term objectives	—	Development objectives

4.4.1 Type of Banks

The focus of banking is varied, the needs diverse and methods different. Thus, we need distinctive kinds of banks to cater to the above mentioned complexities.

Banks can be classified into the following:

1. Commercial banks
2. Cooperative banks
3. Specialised banks
4. Central bank

(i) Commercial Banks: Commercial banks are institutions dealing in money. These are governed by Indian Banking Regulation Act 1949 and according to it banking means accepting deposits of money from the public for the purpose of lending or investment. There are two types of commercial banks, public sector and private sector banks.

Public sectors banks are those in which the government has a major stake and they usually need to emphasise on social objectives than on profitability. Private sector banks are owned, managed and controlled by private promoters and they are free to operate as per market forces. There are a number of public sector banks like SBI, PNB, IOB etc., and other private sector banks represented by HDFC Bank, ICICI Bank, Kotak Mahindra Bank and Jammu and Kashmir Bank.

(ii) Cooperative Banks: Cooperative Banks are governed by the provisions of State Cooperative Societies Act and meant essentially for providing cheap credit to their members. It is an important source of rural credit, i.e., agricultural financing in India.

(iii) Specialised Banks: Specialised banks are foreign exchange banks, industrial banks, development banks, export-import banks catering to specific needs of these unique activities. These banks provide financial aid to industries, heavy turnkey projects and foreign trade.

(iv) Central Bank: The Central bank of any country supervises, controls and regulates the activities of all the commercial banks of that country. It also acts as a government banker. It controls and coordinates currency and credit policies of any country. The Reserve Bank of India is the central bank of our country.

4.4.2 Functions of Commercial Banks

Banks perform a variety of functions. Some of them are the basic or primary functions of a bank while others are agency or general utility services in nature. The important functions are briefly discussed below:

(i) Acceptance of deposits: Deposits are the basis of the loan operations since banks are both borrowers and lenders of money. As borrowers they pay interest and as lenders they grant loans and get interest. These deposits are generally taken through current account, savings account and fixed deposits. Current account deposits can be withdrawn to the extent of the balance at any time without any prior notice.

Savings accounts are for encouraging savings by individuals. Banks pay rate of interest as decided by RBI on these deposits. Withdrawal from these accounts has some restrictions in relation to the amount as well as number of times in a given period. Fixed accounts are time deposits with higher rate of interest as compared to the savings accounts. A premature withdrawal is permissible with a percentage of interest being forfeited.

(ii) Lending of funds: Second major activity of commercial banks is to provide loans and advances out of the money received through deposits. These advances can be made in the form of overdrafts, cash credits, discounting trade bills, term loans, consumer credits and other miscellaneous advances. The funds lent out by banks contribute a great deal to trade, industry, transport and other business activities.

(iii) Cheque facility: Banks render a very important service to their customers by collecting their cheques drawn on other banks. The cheque is the most developed credit instrument, a unique feature and function of banks for the withdrawal of deposits. It is the most convenient and an inexpensive medium of exchange. There are two types of cheques mainly (a) bearer cheques, which are encashable immediately at bank counters and (b) crossed cheques which are to be deposited only in the payees account.

(iv) Remittance of funds: Another salient function of commercial banks is of providing the facility of fund transfer from one place to another, on account of the interconnectivity of branches. The transfer of funds is administered by using bank drafts, pay orders or mail transfers, on nominal commission charges. The bank issues a draft for the amount on its own branches at other places or other banks at those places. The payee can present the draft on the drawee bank at his place and collect the amount.

(v) Allied services: In addition to above functions, banks also provide allied services such as bill payments, locker facilities, underwriting services.

They also perform other services like buying and selling of shares and debentures on instructions and other personal services like payment of insurance premium, collection of dividend etc.

4.4.3 e-Banking

The growth of Internet and e-commerce is dramatically changing everyday life, with the world wide web and e-commerce transforming the world into a digital global village. The latest wave in information technology is internet banking. It is a part of virtual banking and another delivery channel for customers.

In simple terms, internet banking means any user with a PC and a browser can get connected to the banks website to perform any of the virtual banking functions and avail of any of the bank's services. There is no human operator to respond to the needs of the customer. The bank has a centralised data base that is web-enabled. All the services that the bank has permitted on the internet are displayed on a menu. Any service can be selected and further interaction is dictated by the nature of service.

In this new digital market place banks and financial institutions have started providing services over the internet. These type of services provided by the banks on the internet, called e-banking, lowers the transaction cost, adds value to the banking relationship and empowers customers. e-banking is electronic banking or banking using electronic media. Thus, e-banking is a service provided by many banks, that allows, a customer to conduct banking transactions, such as managing savings, checking accounts, applying for loans or paying bills over the internet using a personal computer, mobile telephone or handheld computer (personal digital assistant) The range of services offered by e-banking are: Automated Teller Machines (ATM) and Point of Sales (PoS), Electronic Data Interchange (EDI) and Credit Cards Electronic or Digital cash and Electronic bank transfer (EFT). The two ways in which EFT can be done are: NEFT (National Electronic Fund Transfer) and RTGS (Real Time Gross Settlement).

Benefits

There are various benefits of e-banking provided to customers which are:

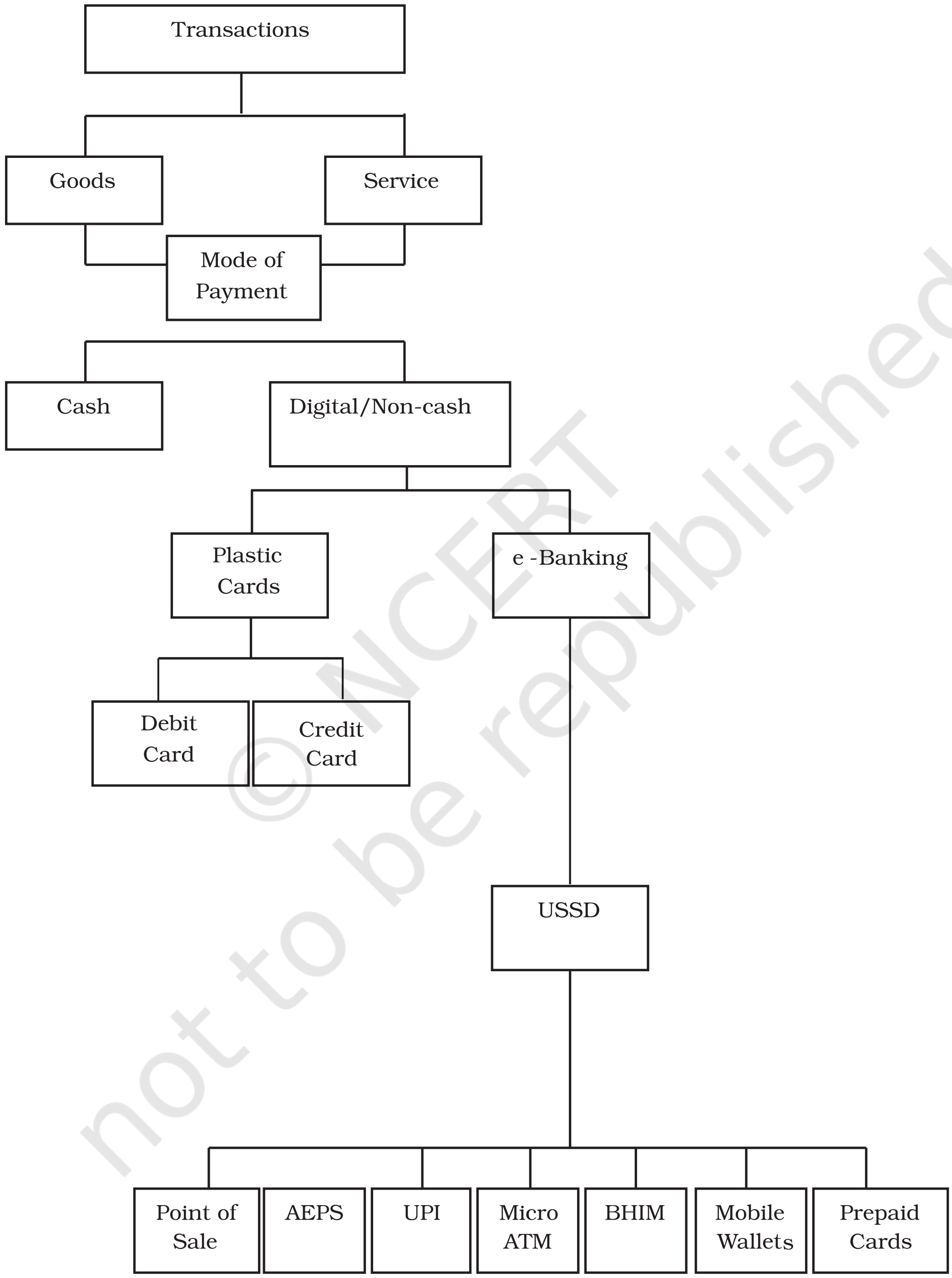
(i) E-banking facilitates digital payments and promotes transparency in financial statements.

(ii) e-banking provides 24 hours, 365 days a year services to the customers of the bank;

(iii) Customers can make some of the permitted transactions from office or house or while travelling via mobile telephone;

(iv) It inculcates a sense of financial discipline by recording each and every transaction;

(v) Greater customer satisfaction by offering unlimited access to the bank, not limited by the walls of the branch and less risk and greater security to the customer as they can avoid travelling with cash.


Transactions
Goods
Service
Mode of Payment
Cash
Digital/Non-cash
Plastic Cards
e -Banking
Debit Card
Credit Card
USSD
Point of Sale
AEPS
UPI
Micro ATM
BHIM
Mobile Wallets
Prepaid Cards

The banks also stand to gain by e-banking. The benefits are:

(i) e-banking provides competitive advantage to the bank;

(ii) e-banking provides unlimited network to the bank and is not limited to the number of branches, Any PC connected to a modem and a telephone having an internet connection can provide cash withdrawl needs of the customer;

(iii) Load on branches can be considerably reduced by establishing centralised data base and by taking over some of the accounting functions.

4.5 Insurance

Life is full of uncertainties. The chances of occurrence of an event causing losses are quite uncertain. There are risks of death and disability for human life; fire and burglary risk for property; perils of the sea for shipment of goods and, so on. If any of these takes place, the individuals and/or, organisations may suffer a great loss, sometimes beyond their capacities to bear the same. It is to minimise the impact of such uncertainties that there is a need for insurance. Investment in factory buildings or heavy equipments or other assets is not possible unless there is arrangement for covering the risks, with the help of insurance. Keeping this in mind, people facing common risks come together and make small contributions to a common fund, which helps to spread the loss caused to an individual by a particular risk over a number of persons who are exposed to it.

Insurance is thus a device by which the loss likely to be caused by an uncertain event is spread over a number of persons who are exposed to it and who prepare to insure themselves against such an event. It is a contract or agreement under which one party agrees in return for a consideration to pay an agreed amount of money to another party to make a loss, damage or injury to something of value in which the insured has a pecuniary interest as a result of some uncertain event. The agreement/contract is put in writing and is known as 'policy'. The person whose risk is insured is called 'insured' and the firm which insures the risk of loss is known as insurer/ assurance underwriter.

4.5.1 Fundamental principle of Insurance

The basic principle of insurance is that an individual or a business concern chooses to spend a definitely known sum in place of a possible huge amount involved in an indefinite future loss. Thus insurance is the substitution of a small periodic payment (premium) for a risk of large possible loss. The loss of risk still remains but the loss is spread over a large number of policyholders exposed to the same risk. The premium paid by them are pooled out of which the loss sustained by any policy holder is compensated. Thus, risks are shared with others. From the analysis of past events the insurer (an insurance company or an underwriter) knows the probable losses caused by each type of risk covered by insurance.

Insurance, therefore, is a form of risk management primarily used to safe guard against the risk of potential financial loss. Ideally, insurance is defined as the equitable transfer of the risk of a potential loss, from one entity to another, in exchange for a reasonable fee. Insurance company, therefore, is an association, corporation or an organisation engaged in the business of paying all legitimate claims that may arise, in exchange for a fee (known as premium).

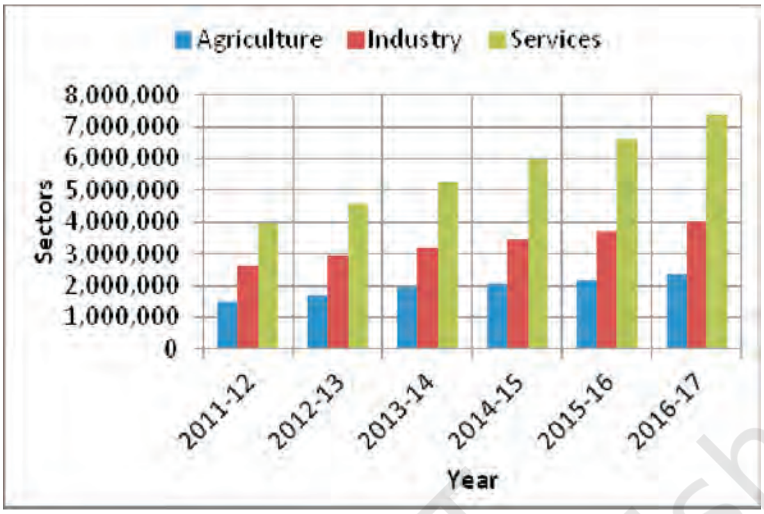
Insurance is a social device in which a group of individuals (insured) transfers risk to another party (insurer) in order to combine loss experience, which provides for payment of losses from funds contributed (premium) by all members. Insurance is meant to protect the insured, against uncertain events, which may cause disadvantage to him.

Sector of Economy and GDP of India

The Indian economy is classified in three sectors — Agriculture and allied, industry and services. The services sector is the largest sector of India. The Gross Value Added (GVA) at current prices for the services sector is estimated at 73.79 lakh crore INR in 2016-17. The services sector accounts for 53.66% of India's total GVA of Rs. 137.51 lakh crore. With GVA of Rs. 39.90 lakh crore, the industry sector contributes 29.05%. While, agriculture and allied sector shares 17.32% and the GVA is around of 23.82 lakh crore INR. At 2011-12 prices, the composition of agriculture and allied, industry, and services sector are 15.11%, 31.12%, and 53.77%, respectively.

	Sector	GVA (Rupees in Crore) at current prices						
		2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	% share
1	**Agriculture Sector**	1,501,816	1,680,798	1,932,692	2,067,935	2,172,910	2,382,289	17.32%
1.1	Agriculture, forestry & fishing	1,501,816	1,680,798	1,932,692	2,067,935	2,172,910	2,382,289	17.32%
2	**Industry Sector**	2,635,052	2,921,262	3,188,270	3,455,221	3,683,358	3,989,791	29.02%
2.1	Mining & quarrying	261,035	285,776	295,716	313,844	296,041	309,178	2.25%
2.2	Manufacturing	1,409,986	1,572,830	1,713,445	1,883,929	2,065,093	2,278,149	16.57%
2.3	Electricity, gas, water supply & other utility services	186,668	215,164	259,840	279,456	321,765	338,396	2.46%
2.4	Construction	777,363	847,492	919,269	977,992	1,000,459	1,064,068	7.74%
3	**Services Sector**	3,969,789	4,603,255	5,245,305	5,947,260	6,595,670	7,378,705	53.66%
3.1	Trade, hotels, transport, communication and services related to broadcasting	1,413,116	1,664,083	1,874,443	2,095,337	2,294,367	2,538,162	18.46%
3.2	Financial & real estate	1,530,691	1,776,023	2,069,386	2,363,328	2,632,432	2,896,300	21.06%
3.3	Public Administration, defence and other services	1,025,982	1,163,149	1,301,476	1,488,595	1,668,871	1,944,243	14.14%
GVA at basic prices		**8,106,656**	**9,205,315**	**10,366,266**	**11,470,415**	**12,451,938**	**13,750,786**	**100.00%**

http:statistimes.com/economy/sectorwisedgp



Source: http://statisticstimes.com/economy/sectorwisegdpcalculationofindia.php

4.5.2 Functions of Insurance

The various functions of insurance are as follows:

(i) Providing certainty: Insurance provides certainity of payment for the risk of loss. There are uncertainties of happenings of time and amount of loss. Insurance removes these uncertainties and the assured receives payment of loss. The insurer charges premium for providing the certainity.

(ii) Protection: The second main function of insurance is to provide protection from probable chances of loss. Insurance cannot stop the happening of a risk or event but can compensate for losses arising out of it.

(iii) Risk sharing: On the happening of a risk event, the loss is shared by all the persons exposed to it. The share is obtained from every insured member by way of premiums.

(iv) Assist in capital formation: The accumulated funds of the insurer received by way of premium payments made by the insured are invested in various income generating schemes.

4.5.3 Principles of Insurance

The principles of insurance are the rules of action or conduct adopted by the stakeholders involved in the insurance business. The specific principles of utmost significance to a valid insurance contract consists of the following:

(i) Utmost good faith: A contract of insurance is a contract of *uberrimae fidei* i.e., a contract found on utmost good faith. Both the insurer and the insured should display good faith towards each other in regard to the contract. It is the duty of the insured to voluntarily make full, accurate disclosure of all facts, material to the risk being proposed and the insurer to make clear all the terms and conditions in the insurance contract. Thus, it is binding on the proposer to disclose all material facts about the subject matter of the proposed insurance. Any fact, which is likely to affect the mind of a prudent insurer in deciding to accept the proposal of insurance or in fixing the rate of premium is material for this purpose. Failure to make disclosure of material facts by the insured makes the contract of insurance voidable at the discretion of the insurer.

(ii) Insurable Interest: The insured must have an insurable interest in the subject matter of insurance. One fundamental fact of this principle is that 'it is not the house, ship, machinery, potential liability of life that is insured, but it is the pecuniary interest of the insured in them, which is insured.' 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 he/she will suffer financially on the happening of the event against which he/she is insured. In case of insurance of property, insurable interest of the insured in the subject matter of the insurance must exist at the time of happening of the event. In order to name insurable interest however, it is not necessary that one should be the owner of the property. For example, a trustee holding property on behalf of others has an insurable interest in the property.

(iii) Indemnity: All insurance contracts of fire or marine insurance are contracts of indemnity. According to it, the insurer undertakes to put the insured, in the event of loss, in the same position that he occupied immediately before the happening of the event insured against. In other words the insurer undertakes to compensate the insured for the loss caused to him/her due to damage or destruction of property insured. The compensation payable and the loss suffered are to be measured in terms of money. The principle of indemnity is not applicable to life insurance.

(iv) Proximate Cause: According to this principle, an insurance policy is designed to provide compensation only for such losses as are caused by the perils which are stated in the policy. When the loss is the result of two or more causes, the proximate cause means the direct, the most dominant and most effective cause of which the loss is the natural consequence. In case of loss arising out of any mishap, the most proximate cause of the mishap should be taken into consideration.

(v) Subrogation: It refers to the right of the insurer to stand in the place of the insured, after settlement of a claim, as far as the right of insured in respect

Examples of facts to be disclosed

Fire insurance: Construction of building, fire detection and fire fighting equipment; nature of its use.
Motor insurance: Type of vehicle; driver details.
Personal Accident insurance: Age, height, weight, occupation, previous medical history.
Life insurance: Age, previous medical history, smoking/drinking habits.

of recovery from an alternative source is involved. After the insured is compensated for the loss or damage to the property insured by him/her the right of ownership of such property passes on to the insurer. This is because the insured should not be allowed to make any profit, by selling the damaged property or in the case of lost property being recovered.

(vi) Contribution: As per this principle it is the right of an insurer who has paid claim under an insurance, to call upon other liable insurers to contribute for the loss of payment. It implies, that in case of double insurance, the insurers are to share the losses in proportion to the amount assured by each of them. In case there is a loss, when there is more than one policy on the same property, the insured will have no right to recover more than the full amount of his actual loss. If the full amount is recovered from one insurer the right to obtain further payment from the other insurer will cease.

(vii) Mitigation: This principle states that it is the duty of the insured to take reasonable steps to minimise the loss or damage to the insured property. Suppose goods kept in a store house catch fire then the owner of the goods should try to recover the goods and save them from fire to minimise the loss or damage. The insured must behave with great prudence and not be careless just because there is an insurance cover. If reasonable care is not taken like any prudent person then the claim from the insurance company may be lost.

4.5.4 Types of Insurance

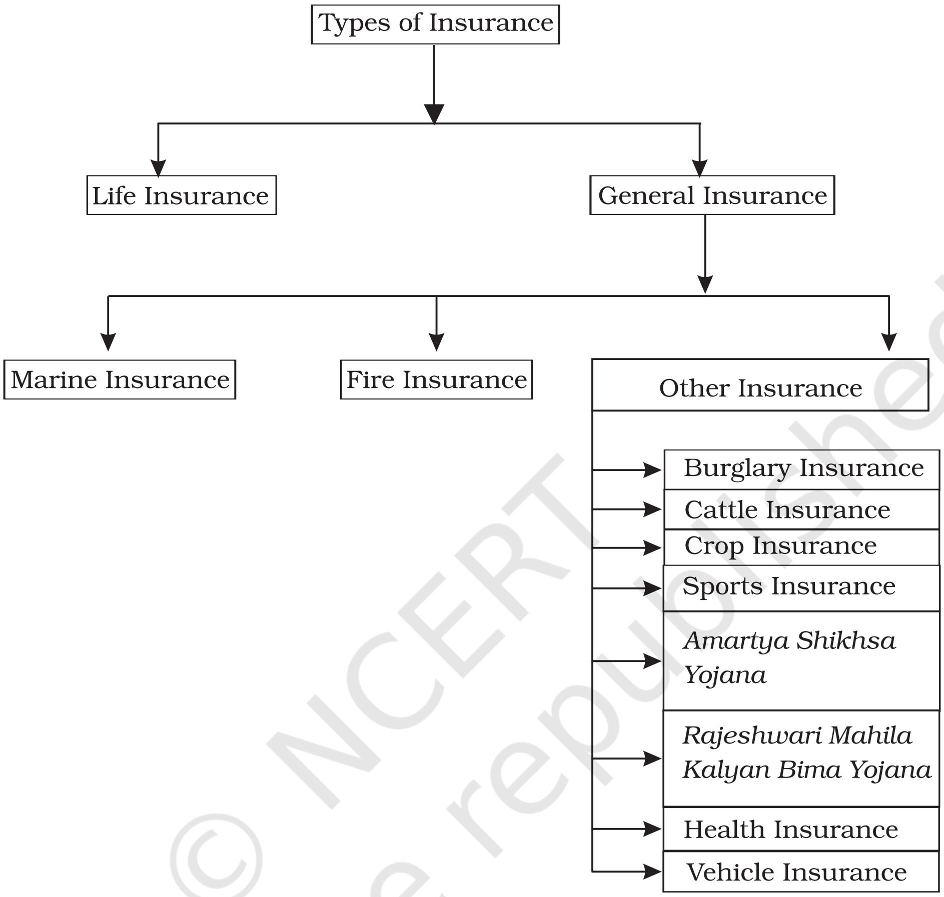
Various types of insurance exist by virtue of practice of insurance companies and the influence of legal enactments controlling the insurance business. Broadly speaking, insurance may be classified as follows:

Life Insurance

Since life itself is uncertain, all individuals try to assure themselves of a certain sum of money in the future to take care of unforeseen events or happenings. Individuals in the course of their life are always exposed to some kind of risks.

The risk may be of an event which is certain that is death. In that case, what will happen to the other members of the family who are dependent on a particular individuals income. The other risk may be living too long in which an individual may become too old to earn i.e., retirement. In this case also, the earnings will decline or end. Under such circumstances, individuals seek protection against these risks and life insurance companies offer protection against such risks.

A life insurance policy was introduced as a protection against the uncertainity of life. But gradually its scope has widened and there are various types of insurance policies available to suit the requirements of an individual. For example, disability insurance, health/medical insurance, annuity insurance and life insurance proper.



Life insurance may be defined as a contract in which the insurer in consideration of a certain premium, either in a lump sum or by other periodical payments, agrees to pay to the assured, or to the person for whose benefit the policy is taken, the assured sum of money, on the happening of a specified event contingent on the human life or at the expiry of certain period. Thus, the insurance company undertakes to insure the life of a person in exchange for a sum of money called premium. This premium may be paid in one lump sum, or periodically i.e., monthly, quarterly, half yearly or yearly. At the same time, the company promises to pay a certain sum of money either on the death of the person or on his attaining a certain age (i.e., the expiry of certain period). Thus, the person is sure that a specified amount will be given to him when he attains a certain age or that his dependents will get that sum in the event of his death.

This agreement or contract which contains all the terms and conditions is put in writing and such document is called the policy. The person whose life is insured is called the assured. The insurance company is the insurer and the consideration paid by the assured is the premium. The premium can be paid periodically in instalments.

This insurance provides protection to the family at the premature death or gives adequate amount at old age when earning capacities are reduced. The insurance is not only a protection but is a sort of investment because a certain sum is returnable to the insured at the time of death or at the expiry of a certain period.

Life insurance also encourages savings as the amount of premium has to be paid regularly. It thus, provides a sense of security to the insured and his dependents.

The general principles of insurance discussed in the previous section apply to life insurance also with a few exceptions. The main elements of a life insurance contract are:

(i) The life insurance contract must have all the essentials of a valid contract. Certain elements like offer and acceptance, free consent, capacity to enter into a contract, lawful consideration and lawful object must be present for the contract to be valid;

(ii) The contract of life insurance is a contract of utmost good faith. The assured should be honest and truthful in giving information to the insurance company. He must disclose all material facts about his health to the insurer. It is his duty to disclose accurately all material facts known to him even if the insurer does not ask him;

(iii) In life insurance, the insured must have insurable interest in the life assured. Without insurable interest the contract of insurance is void. In case of life insurance, insurable interest must be present at the time when the insurance is affected. It is not necessary that the assured should have insurable interest at the time of maturity also. For example, a person is presumed to have an interest in his own life and every part of it, a creditor has an insurable interest in the life of his debtor, and a proprietor of a drama company has an insurable interest in the lives of the actors;

(iv) Life insurance contract is not a contract of indemnity. The life of a human being cannot be compensated and only a specified sum of money is paid. That is why the amount payable in life insurance on the happening of the event is fixed in advance. The sum of money payable is fixed, at the time of entering into the contract. A contract of life insurance, therefore, is not a contract of indemnity.

Types of life insurance policies

The document containing the written contract between the insurer and the insured alongwith the terms and conditions of insurance is called the Policy. After the proposal form is filled by the insured (or the proposer) and the insurer (insurance company) accepts the form and the premium, a policy is issued to the insurer.

People have different requirements and therefore they would like a policy to fulfill all their needs. The needs of people for life insurance can be family needs, children's needs, old age and special needs. To meet the needs of people the insurers have developed different types of products such as Whole Life Assurance, Endowment type plans, combination of Whole Life and Endowment type plans, Children's Assurance plans and Annuity plans. Some of these are explained below:

(i) Whole Life Policy: In this kind of policy, the amount payable to the insured will not be paid before the death of the assured. The sum then becomes payable only to the beneficiaries or heir of the deceased.

The premium will be 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: The insurer (Insurance Company) undertakes to pay a specified sum when the insured attains a particular age or on his death which ever is earlier. The sum is payable to his legal heir/s or nominee named therein in case of death of the assured. Otherwise, the sum will be paid to the assured after a fixed period i.e., till he/she attains a particular age. Thus, the endowment policy matures after a limted number of years.

(iii) Joint Life Policy: This policy is taken up by two or more persons. The premium is paid jointly or by either of them in instalments or lump sum. The assured sum or policy money is payable upon the death of any one person to the other survivor or survivors. 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 after the assured attains a certain age in monthly, quarterly, half yearly or annual instalments. The premium is paid in instalments over a certain period or single premium may be paid by the assured. This is useful to those who prefer a regular income after a certain age.

(v) Children's Endowment Policy: This policy is taken by a person for his/her children to meet the expenses of their education or marriage. The agreement states that a certain sum will be paid by the insurer when the children attain a particular age. The premium is paid by the person entering into the contract. However, no premium wil be paid, if he dies before the maturity of the policy.

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 fire during a specified period upto the amount specified in the policy. Normally, the fire insurance policy is for a period of one year after which it is to be renewed from time to time. The premium may be paid either in lump sum or instalments. A claim for loss by fire must satisfy the two following conditions:

(i) There must be actual loss; and
(ii) Fire must be accidental and non-intentional.

The risk covered by a fire insurance contract is the loss resulting from fire or some other cause, and which is the proximate cause of the loss. If overheating without ignition causes damage, it will not be regarded as a fire loss within the meaning of fire insurance and the loss will not be recoverable from the insurer.

A fire insurance contract is based on certain fundamental principles which have been discussed in general principles. The main elements of a fire insurance contract are:

(i) In fire insurance, the insured must have insurable interest in the subject matter of the insurance. Without insurable interest the contract of insurance is void. In case of fire insurance, unlike life insurance insurable interest must be present both at the time of insurance and at the time of loss. For example, a person has insurable interest in the property he owns, a businessman has insurable interest in his stock, plant, machinery and building, an agent has an insurable interest in the property of his principal, a partner has insurable interest in the property of a partnership firm, and a mortgagee has insurable interest in the property, which is mortgaged.
(ii) Similar to the life insurance contract, the contract of fire insurance is a contract of utmost good faith i.e., *uberrimae fidei*. The insured should be truthful and honest in giving information to the insurance company regarding the subject matter of the insurance. He is duty-bound to disclose accurately all facts regarding the nature of property and risks attached to it. The insurance company should also disclose the facts of the policy to the proposer.
(iii) The contract of fire insurance is a contract of strict indemnity. The insured can, in the event of loss, recover the actual amount of loss from the insurer. This is subject to the maximum amount for which the subject matter is insured. For example, if a person has insured his house for Rs. 4,00,000 the insurer is not necessarily liable to pay that amount, although the house may have been totally destroyed by fire; but he will pay the actual loss after deducting depreciation within the maximum limit of Rs. 4,00,000. The purpose being that a person should not be allowed to gain by insurance.
(iv) The insurer is liable to compensate only when fire is the proximate cause of damage or loss.

Marine Insurance

A marine insurance contract is an agreement whereby the insurer undertakes to indemnify the insured in the manner and to the extent thereby agreed against marine losses. Marine insurance provides protection against loss by marine perils or perils of the sea.

Difference between Life, Fire and Marine Insurance

	Basis of difference	Life Insurance	Fire insurance	Marine Insurance
1.	Subject Matter	The subject matter of insurance is human life.	The subject matter is any physical property or assets.	The subject matter is a ship, cargo or freight.
2.	Element	Life Insurance has the elements of protection and investment or both.	Fire insurance has only the element of protection and not the element of investment.	Marine insurance has only the element of protection.
3.	Insurable interest	Insurable interest must be present at the time of effecting the policy but need not be necessary at the time when the claim falls due.	Insurable interest on the subject matter must be present both at the time of effecting policy as well as when the claim falls due.	Insurable interest must be present at the time when claim falls due or at the time of loss only.
4.	Duration	Life insurance policy usually exceeds a year and is taken for longer periods ranging from 5 to 30 years or whole life.	Fire insurance policy usually does not exceed a year.	Marine insurance policy is for one or period of voyage or mixed.
5.	Indemnity	Life insurance is not based on the principle of indemnity. The sum assured is paid either on the happening of certain event or on maturity of the policy.	Fire insurance is a contract of indemnity. The insured can claim only the actual amount of loss from the insurer. The loss due to the fire is indemnified subject to the maximum limit of the policy amount.	Marine insurance is a contract of indemnity. The insured can claim the market value of the ship and cost of goods destroyed at sea and the loss will be indemnified.
6.	Loss measurement	Loss is not measurable.	Loss is measurable.	Loss is measurable.
7.	Surrender value or paid up value	Life insurance policy has a surrender value or paid up value.	Fire insurance does not have any surrender value or paid up value.	Marine insurance does not have any surrender value or paid up value.

8.	Policy amount	One can insure for any amount in life insurance.	In fire insurance, the amount of the policy cannot be more than the value of the subject matter.	In marine insurance the amount of the policy can be the market value of the ship or cargo.
9.	Contingency of risk	There is an element of certainity. The event i.e., death of maturity or policy is bound to happen. Therefore a claim will be present.	The event i.e., destruction by fire may not happen. There is an element of uncertainity and there may be no claim.	The event i.e., loss at sea may not occur and there may be no claim. There is an element of uncertainty.

Marine perils are collision of ship with the rock, or ship attacked by the enemies, fire and captured by pirates and actions of the captains and crew of the ship. These perils cause damage, destruction or disappearance of the ship and cargo and non-payment of freight. So, marine insurance insures ship hull, cargo and freight. Thus, it is a device wherein the insurer undertakes to compensate the owner of a ship or cargo for complete or partial loss at sea. The insurer gurantees to make good the losses due to damage to the ship or cargo arising out of the risks incidental to sea voyages. The insurer in this case is known as the underwriter and a certain sum of money is paid by the insured in consideration for the guarantee/ protection he gets. Marine insurance is slightly different from other types. There are three things involved i.e., ship or hull, cargo or goods, and freight.

(a) Ship or hull insurance: Since the ship is exposed to many dangers at sea, the insurance policy is for indemnifying the insured for losses caused by damage to the ship.

(b) Cargo insurance: The cargo while being transported by ship is subject to many risks. These may be at port i.e., risk of theft, lost goods or on voyage etc. Thus, an insurance policy can be issued to cover against such risks to cargo.

(c) Freight insurance: If the cargo does not reach the destination due to damage or loss in transit, the shipping company is not paid freight charges. Freight insurance is for reimbursing the loss of freight to the shipping company i.e., the insured.

The fundamental principles of marine insurance are the same as the general principles. The main elements of a marine insurance contract are:

(i) Unlike life insurance, the contract of marine insurance is a contract of indemnity. The insured can, in the event of loss recover the actual amount of loss from the insurer. Under no circumstances, the insured is allowed to make profit out of the marine insurance contract. But cargo policies provide commercial indemnity rather than strict indemnity. The insurers promise to indemnify the insured *"in the manner and to the extent agreed."* In case of 'Hull Policy', the amount insured is fixed at a level above the current market value;

(ii) Similar to life and fire insurance, the contract of marine insurance is a contract of utmost good faith. Both the insured and insurer must disclose everything, which is in their knowledge and can affect the insurance contract. The insured is duty-bound to accurately disclose all facts which include the nature of shipment and the risk of damage it is exposed to;

(iii) Insurable interest must exist at the time of loss but not necessary at the time when the policy was taken;

(iv) The principle of *causa proxima* will apply to it. The insurance company will be liable to pay only if that particular or nearest cause is covered by the policy. For example, if a loss is caused by several reasons then nearest cause of loss will be considered. Refer to page 105 for types of insurance and social secuirty scheme.

4.6 Communication Services

Communication services are helpful to the business for establishing links with the outside world viz., suppliers, customers, competitors etc. Business does not exist in isolation, it has to communicate with others for transmission of ideas and information. Communication services need to be very efficient, accurate and fast for them to be effective. In this fast moving and competitive world it is essential to have advanced technology for quick exchange of information. The electronic media is mainly responsible for this transformation. The main services which help business can be classified into postal and telecom.

Postal Services

Indian post and telegraph department provides various postal services across India. For providing these services the whole country has been divided into 22 postal circles. These circles manage the day-to-day functioning of the various head post offices, sub-post offices and branch post offices. Through their regional and divisional level arrangements the various facilities provided by postal department are broadly categorised into:

(i) Financial facilities: These facilities are provided through the post office's savings schemes like Public Provident Fund (PPF), *Kisan Vikas Patra*, and National Saving Certificates in addition to normal retail banking functions of monthly income schemes, recurring deposits, savings account, time deposits and money order facility.

(ii) Mail facilities: Mail services consist of parcel facilities that is transmission of articles from one place to another; registration facility to provide security of the transmitted articles and insurance facility to provide insurance cover for all risks in the course of transmission by post.

Postal department also offers allied facilities of the following types:

1. Greeting post — A range of delightful greeting cards for every occasion.
2. Media post — An innovative and effective vehicle for Indian corporates to advertise their brand through postcards, envelopes, aerograms, telegrams, and also through letterboxes.
3. Direct post is for direct advertising. It can be both addressed as well as unaddressed.
4. International Money Transfer through collaboration with Western Union financial services, USA, which enables remittance of money from 185 countries to India.
5. Passport facilities — A unique partnership with the ministry of external affairs for facilitating passport application.
6. Speed Post: It has over 1000 destinations in India and links with 97 major countries across the globe.
7. e-bill post is the latest offering of the department to collect bill payment across the counter for BSNL and Bharti Airtel.

Telecom Services

World class telecommunications infrastructure is the key to rapid economic and social development of the country. It is in fact the backbone of every business activity. In today's world the dream of doing business across continents will remain a dream in the absence of telecom infrastructure. There have been far reaching developments in the convergence of telecom, IT, consumer electronics and media industries worldwide. Recognising the potential in enhancing quality of life and to facilitate India's vision of becoming IT super power by the year 2025, new Telecom Policy Framework 1999 and Broadband Policy 2004 were developed by the Government of India. Through this framework the government intends to provide both universal services to all uncovered areas and high-level services for meeting the needs of the country's economy.

The various types of telecom services are:

(i) Cellular mobile services: These are all types of mobile telecom services including voice and non-voice messages, data services and PCO services utilising any type of network equipment within their service area. They can also provide direct inter connectivity with any other type of telecom service provider.

(ii) Fixed line services: These are all types of fixed services including voice and non-voice messages and data services to establish linkages for long distance traffic. These utilise any type of network equipment primarily connected through fiber optic cables laid across the length and breadth of the country. The also provide inter connectivity with other types of telecom services.

(iii) Cable services: These are linkages and switched services within a licensed area of operation to operate media services, which are essentially one-way entertainment related services. The two-way communication including voice, data and information services through cable network would emerge significantly in the future. Offering services through the cable network would be similar to providing fixed services.

(iv) VSAT services: VSAT (Very Small Aperture Terminal) is a satellite-based communications service. It offers businesses and government agencies a highly flexible and reliable communication solution in both urban and rural areas. Compared to land-based services, VSAT offers the assurance of reliable and uninterrupted service that is equal to or better than land-based services. It can be used to provide innovative

Different Types of Insurance

1. Health Insurance

Health Insurance is a safeguard against rising medical costs. A 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 (the premium). Depending upon the policy, premium may be payable either in a lump sum or in instalments. Health insurance usually provides either direct payment or reimbursement for expenses associated with illness and injuries. The cost and range of protection provided by health insurance depends on the provider and the policy purchased. In India, presently the health insurance exists primarily in the form of Mediclaim policy offered to an individual or to any group, association or corporate bodies.

2. Motor Vehicle Insurance

Motor Vehicle Insurance falls under the classification of General Insurance. This insurance is becoming very popular and its importance increasing day-by-day. In motor insurance the owner's liability to compensate people who were killed or insured through negligence of the motorists or drivers is passed on to the insurance company. The rate of premium under motor insurance is standardised.

3. Burglary Insurance

Burglary insurance falls under the classification of insurance of property. In case of burglary policy, the loss of damages of household goods and properties and personal effects due to theft, larceny, burglary, house-breaking and acts of such nature are covered. The actual loss is compensated.

(i) Insurable interest must exist at the time of loss but not necessarily at the time when the policy was taken.

(ii) The principle of *causa proxima* will apply to it. The insurance company will be liable to pay only that particular or nearest cause that is covered by the policy. For example, if a loss is caused by several reasons then the nearest cause of loss will be considered.

4. Cattle Insurance

A contract of cattle insurance is a contract whereby a sum of money is secured to the assured in the event of death of animals like bulls, buffaloes, cows and heifers. It is a contract against death resulting from accident, disease, or pregnant condition as the case may be. The insurer usually undertakes to pay the excess in the event of loss.

5. Crop Insurance

A contract of crop insurance is a contract to provide a measure of financial support to farmers in the event of a crop failure due to drought or flood. This insurance covers against all risks of loss or damages relating to production of rice, wheat, millets, oil seeds and pulses etc.

6. Sports Insurance

This policy assures a comprehensive cover available to amateur sportsmen covering their sporting equipment, personal effects, legal liability and personal accident risks. If desired the cover can also be made available in respect of the named member of insured's family residing with him. This cover is not available to professional sportsmen. The cover is available in respect of any one or more of the following sports: angling, badminton, cricket, golf, lawn tennis, squash, use of sporting guns.

7. *Amartya Sen Siksha Yojana*

This policy offered by the General Insurance Company secures the education of dependent children. If the insured parent/legal guardian sustains any bodily injury resulting solely and directly from an accident, caused by external, violent and visible means and if such injury shall within twelve calendar months of its occurrence be the sole and 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 date of policy or completion of the duration of covered course whichever occurs first and such indemnity shall not exceed the sum insured as stated in the policy schedule.

8. *Rajeswari Mahila Kalyan Bima Yojana*

This policy has been designed to provide relief to the family members of insured women in case of their death or disablement arising due to all kinds of accidents and/or death and/or disablement arising out of problems incidental to women only.

Social Security Schemes

1. ***Atal Pension Yojana* :** This scheme is offered to individuals in the age group of 18 to 40 years. The individual is expected to contribute in the scheme until he/she attains the age of 60 years. The scheme acts as an investment for availing old-age pension.
2. ***Pradhan Mantri Suraksha Bima Yojana* :** This scheme offers accidental and disability cover of Rs. 2 lakh at a premium of Rs. 12 per year. Any individual holding a savings account can be enrolled under this scheme.
3. ***Pradhan Mantri Jan Dhan Yojana* :** The scheme offers savings account with no minimum balance. The Rupay ATM-cum-Debit card has in-built accident and life cover of Rs. 1,00,000 and Rs. 30,000, respectively. The scheme, suitable for economically weaker sections of society.
4. ***Pradhan Mantri Jeevan Jyoti Bima Yojana* :** The scheme offers a protection term insurance cover of Rs 2,00,000 to the dependents of the policy holder in the event of his/her death at a premium of Rs. 330 per year. Any individual in the age group of 18-70 years having a savings account can opt for this scheme.

applications such as tele-medicine, newspapers-on-line, market rates and tele-education even in the most remote areas of our country.

(v) DTH services: DTH (Direct to Home) is again a satellite-based media services provided by cellular companies. One can receive media services directly through a satellite with the help of a small dish antenna and a set top box. The service provider of DTH services provides a bouquet of multiple channels. It can be viewed on our television without being dependent on the services provided by the cable network services provider.

4.7 Transportation

Transportation comprises freight services together with supporting and auxiliary services by all modes of transportation i.e., rail, road, air and sea for the movement of goods and international carriage of passengers. You have already studied the comparative advantages and disadvantages of different modes of transportation in earlier classes. Their services are considered to be important for business since speed is of essence in any business transaction. Also transportation removes the hindrance of place, i.e., it makes goods available to the consumer from the place of production. We need to develop our transportation system to keep pace with the requirements of our economy. We need better infrastructure of roads with sufficient width and high quality. We have few ports and they too are congested. Both government and industry needs to be proactive and view the effective functioning of this service as a necessity for providing a lifeline to a business services. In sectors like agriculture and food, there are massive losses of product in the process of transportation and storage.

Infrastructure in Transportation

In the first, 50 years of independence, India saw the construction of around 13, 000 kilometers of national highways. The ambitious NHAI, Government of India's project consisting of Golden Quadrilateral connecting Delhi-Kolkata-Chennai-Mumbai and the North-South, East-West corridors linking Srinagar to Kanyakumari and Silchar to Porbandar will see the construction of 13,151 kms of National Highways within a span of eight years. This project will not only change the face of road transport in India, but it will also have a lasting impact on our economy. The Ministry of Railways have also done massive innovations in their movement and monitoring of goods trains to facilitate the needs of the business community.

The Government of India is also serious in ensuring better and more facilities at the seaports and airports to provide an impetus to business activities. The government plans not only to enhance capacities of existing ports but also to develop modern and new ports at strategic locations.

Warehousing

Storage has always been an important aspect of economic development. The warehouse was initially viewed as a static unit for keeping and storing goods in a scientific and systematic manner so as to maintain their original quality, value and usefulness. The typical warehouse received merchandise by rail, truck or bullock cart. The items were moved manually to a storage within the warehouse and hand piled in stacks on the floor. They are used by manufacturers, importers, exporters, wholesalers, transport business, customs etc., in India.

Today's warehouses have ceased to be a mere storage service providers and have really become logistical service providers in a cost efficient manner. That is making available the right quantity, at the right place, in the right time, in the right physical form at the right cost. Modern warehouses are automated with automatic conveyors, computer operated cranes and forklifts for moving goods and also usage of logistics automation software's for warehouse management.

Types of Warehouses

(i) Private warehouses: Private warehouses are operated, owned or leased by a company handling their own goods, such as retail chain stores or multi-brand multi-product companies. As a general rule an efficient warehouse is planned around a material handling system in order to encourage maximum efficiency of product movement. The benefit of private warehousing includes control, flexibility, and other benefits like improved dealer relations.

(ii) Public warehouses: Public warehouses can be used for storage of goods by traders, manufacturers or any member of the public after the payment of a storage fee or charges. The government regulates the operation of these warehouses by issuing licences for them to private parties.

The owner of the warehouse stands as an agent of the owner of the goods and is expected to take appropriate care of the goods.

These warehouses provide other facilities also, like transportation by rail and road. They are responsible for the safety of the goods. Small manufacturers find it convenient as they cannot afford to construct their own warehouses.

The other benefits include flexibility in the number of locations, no fixed cost and capability of offering value added services, like packaging and labelling.

(iii) Bonded warehouses: Bonded warehouses are licensed by the government to accept imported goods prior to payment of tax and customs duty. These are goods which are imported from other countries. Importers are not permitted to remove goods from the docks or the airport till customs duty is paid.

At times, importers are not in a position to pay the duty in full or does not require all the goods immediately. The goods are kept in bonded warehouses by the customs authorities till the customs duty is paid. These goods are said to be in bond.

These warehouses have facilities for branding, packaging, grading and blending. Importers may bring their buyers for inspection of goods and repackage them according to their requirements. Thus, it facilitates marketing of goods.

Goods can be removed in part as and when required by the importers and buyers, and import duty can be paid in instalments.

The importer need not block funds for payment of import duties before the goods are sold or used. Even if he wishes to export the goods kept in the bonded warehouse he may do so without payment of customs duty. Thus, bonded warehouses facilitate entrepot trade.

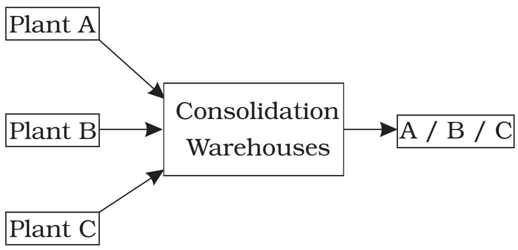
(iv) Government warehouses: These warehouses are fully owned and managed by the government. The government manages them through organisations set up in the public sector. For example, Food Corporation of India, State Trading Corporation, and Central Warehousing Corporation.

(v) Cooperative warehouses: Some marketing cooperative societies or agricultural cooperative socities have set up their own warehouses for members of their cooperative society.

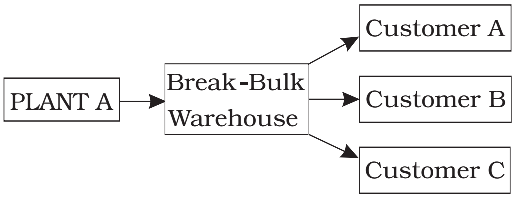
Functions of Warehousing

The functions of warehousing are discussed as follows:

(a) Consolidation: In this function the warehouse receives and consolidates, materials/goods from different production plants and dispatches the same to a particular customer on a single transportation shipment.



(b) Break the bulk: The warehouse performs the function of dividing the bulk quantity of goods received from the production plants into smaller quantities. These smaller quantities are then transported according to the requirements of clients to their places of business.



Central Warehousing Corporation

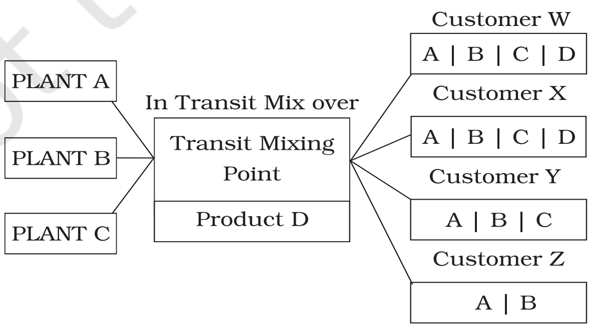
At present, a Central Government undertaking CWC i.e., Central Warehousing Corporation provides these services for businessmen across the country. Private warehousing companies, like TCI, *Shanker* International, Blue Dart, DHL, etc., are providing cargo facilities of both transportation and warehousing.

(c) Stock piling: The next function of warehousing is the seasonal storage of goods to select businesses. Goods or raw materials, which are not required immediately for sale or manufacturing, are stored in warehouses. They are made available to business depending on customers' demand. Agricultural products which are harvested at specific times with subsequent consumption throughout the year also need to be stored and released in lots.

(d) Value added services: Certain value added services are also provided by the warehouses, such as in transit mixing, packaging and labelling. Goods sometimes need to be opened and repackaged and labelled again at the time of inspection by prospective buyers. Grading according to quantity and dividing goods in smaller lots is another function.

(e) Price stablisation: By adjusting the supply of goods with the demand situation, warehousing performs the function of stabilising prices. Thus, prices are controlled when supply is increasing and demand is slack and vice versa.

(f) Financing: Warehouse owners advance money to the owners on security of goods and further supply goods on credit terms to customers.



Key Terms

Business services	Insurance	Subrogation	Fire insurance
Banking	Insurable interest	Contribution	Marine insurance
e-Banking	Indemnity	Mitigation	Telecom services
Commercial banks	Proximate cause	Life insurance	Warehousing

SUMMARY

Nature of services: Services are those separately identifiable, essentially intangible activities that provide satisfaction of wants, and are not necessarily linked to the sale of a product or another service. There are five basic features of services. These features also distinguish them from goods and are known as the five Is of services i.e., Intangibility, Inconsistency, Inseparability, Inventory (less), Involvement.

Difference between services and goods: While goods are produced, services are performed. A service is an act which cannot be taken home. What we can take home is the effect of the services. And as the services are sold at the consumption point, there are no inventories.

Types of services: Business Services, Social Services, Personal Services.

Business services: In order to be competitive, business enterprises are becoming more and more dependent on specialised business services. Business enterprises look towards banks for availability of funds; insurance companies for getting their plant, machinery, goods, etc., insured; transport companies for transporting raw material and finished goods; and telecom and postal services for being in touch with their vendors, suppliers and customers.

Banking: A banking company in India is one which transacts the business of banking which means accepting, for the purpose of lending and investment of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheques, draft, order or otherwise.

Type of banks: Banks can be classified into the following i.e., commercial banks, cooperative banks, specialised banks, central bank.

Functions of commercial bank: Some of them are the basic or primary functions of a bank while others are agency services or general utility services in nature. Acceptance of deposits, lending of funds, cheque facility, remittance of funds, allied services.

e-Banking: The latest wave in information technology is internet banking. It is a part of virtual banking and another delivery channel for customers. e-banking is electronic banking or banking using the electronic media. Thus, e-banking is a service provided by many banks, that allows a customer to conduct banking transactions, such as managing savings, checking accounts, applying for loans or paying bills over the internet using a personal computer, mobile telephone or handheld computer (personal digital assistant)

Insurance: Insurance is thus a device by which the loss likely to be caused by an uncertain event is spread over a number of persons who are exposed to it and who are prepared to insure themselves against such an event. It is a contract or agreement under which one party agrees in return for a consideration to pay an agreed amount of money to another party to make good a loss, damage or injury to something of value in which the insured has a pecuniary interest as a result of some uncertain event.

Fundamental principle of insurance: The basic principle of insurance is that an individual or a business concern chooses to spend a definitely known sum in place of a possible huge amount involved in an indefinite future loss. Insurance, therefore, is a form of risk management primarily used to safe guard against the risk of potential financial loss.

Functions of insurance: Providing certainty, Protection, Risk sharing, Assist in capital formation.

Principles of Insurance

Utmost good faith: A contract of insurance is a contract of uberrimae fidei i.e., a contract found on utmost good faith. Both the insurer and the insured display good faith towards each other in regard to the contract.

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.

Indemnity: According to it, the insurer undertakes to put the insured, in the event of loss, in the same position that he occupied immediately before the happening of the event insured against.

Proximate cause: When the loss is the result of two or more causes, the proximate cause means the direct, the most dominant and most effective cause of which the loss is a natural consequence.

Subrogation: It refers to the right of the insurer to stand in the place of the insured, after settlement of a claim, as far as the right of the insured in respect of recovery from an alternative source is involved.

Contribution: As per this principle it is the right of an insurer who has paid claim under an insurance, to call upon other liable insurers to contribute for the loss payment.

Mitigation: This principles states that it is the duty of the insured to take reasonable steps to minimise the loss or damage to the insured property.

Types of Insurance

Life insurance: Life insurance may be defined as a contract in which the insurer, in consideration of a certain premium, either in a lump sum or by other periodical payments, agrees to pay to the assured, or to the person for whose benefit the policy is taken, the assured sum of money, on the happening of a specified event contingent on the human life or at the expiry of a certain period.

This insurance provides protection to the family at premature death of an individual or gives adequate amount at an old age when earning capacities are reduced. The insurance is not only a protection but is a sort of investment because a certain sum is returnable to the insured at the time of death or at the expiry of a certain period.

The main elements of a life insurance contract are:

(i) The life insurance contract must have all the essentials of a valid contract.

(ii) The contract of life insurance is a contract of utmost good faith.

(iii) In life insurance, the insured must have insurable interest in the life assured.

(iv) Life insurance contract is not a contract of indemnity.

Types of life insurance policies: People have different requirements and therefore they would like a policy to fulfill all their needs. The needs of people for life insurance can be family needs, children's needs, old age and special needs. To meet the needs of people the insurer's have developed different types of products such as Whole Life Assurance, Endowment type plans, combination of Whole Life and Endowment type plans, Children's Assurance plans and Annuity plans.

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.

The main elements of a fire insurance contract are:

(i) In fire insurance, the insured must have insurable interest in the subject matter of the insurance.

(ii) Similar to the life insurance contract, the contract of fire insurance is a contract of utmost good faith i.e., uberrimae fidei.

(iii) The contract of fire insurance is a contract of strict indemnity.

(iv) The insurer is liable to compensate only when fire is the proximate cause of damage or loss.

Marine insurance: A marine insurance contract is an agreement whereby the insurer undertakes to indemnify the insured in the manner and to the extent thereby agreed against marine losses. Marine insurance provides protection against loss by marine perils or perils of the sea. Marine insurance is slightly different from other types. There are three things involved i.e., ship or hull, cargo or goods and freight.

The main elements of a marine insurance contract are:

(i) Unlike life insurance, the contract of marine insurance is a contract of indemnity.

(ii) Similar to life and fire insurance, the contract of marine insurance is a contract of utmost good faith.

(iii) Insurable interest must exist at the time of loss.

(iv) The principle of causa proxima will apply to it.

Communication services: Communication services are helpful to business for establishing links with the outside world viz., suppliers, customers, competitors etc. The main services which help business can be classified into postal and telecom.

Postal services: Various facilities provided by postal department are broadly categorised into financial facilities, mail facilities.

Telecom services: The various types of telecom services are of the following types: Cellular Mobile Services, Radio Paging Services, Fixed line services, Cable Services, VSAT Services, DTH services.

Transportation: Transportation comprises freight services together with supporting and auxiliary services by all modes of transportation i.e., rail, road, air and sea for the movement of goods and international carriage of passengers.

Warehousing: The warehouse was initially viewed as a static unit for keeping and storing goods in a scientific and systematic manner so as to maintain their original quality, value and usefulness.

Today's warehouses have ceased to be mere storage service providers and have really become logistical service providers in a cost efficient manner.

Types of warehouses: private warehouses, public warehouses,bonded warehouses, government warehouses, cooperative warehouses.

Functions of warehousing: The functions of warehousing are normally discussed as follows : consolidation, break the bulk, stock piling, value added services, price stablisation, financing.

EXERCISES

Multiple Choice Questions

1. DTH services are provided by________.

   a. Transport companies. b. Banks
   c. Cellular companies d. None of the above

2. The benefits of public warehousing includes______.
   a. Control
   b. Flexibility
   c. Dealer relationship
   d. None of the above
3. Which of the following is not a function of insurance?
   a. Risk sharing
   b. Assist in capital formation
   c. Lending of funds
   d. None of the above
4. Which of the following is not applicable in life insurance contract?
   a. Conditional contract
   b. Unilateral contract
   c. Indemnity contract
   d. None of the above
5. CWC stands for______.
   a. Central Water Commission
   b. Central Warehousing Commission
   c. Central Warehousing Corporation
   d. Central Water Corporation

Short Answer Questions

1. Define services and goods.
2. What is e-banking. What are the advantages of e-banking?
3. Write a note on various telecom services available for enhancing business.
4. Explain briefly the principles of insurance with suitable examples.
5. Explain warehousing and its functions.

Long Answer Questions

1. What are services? Explain their distinct characteristics.
2. Explain the functions of commercial banks with an example of each.
3. Write a detailed note on various facilities offered by Indian Postal Department.
4. Describe various types of insurance and examine the nature of risks protected by each type of insurance.
5. Explain in detail the warehousing services.

Projects/Assignments

1. Identify a list of various services you use on a regular basis and identify their distinct characteristics.
2. Do a project on banking services. Approach a nearby bank and collect information about various services offered by them and also collect leaflets about salient features of different schemes. Compile and suggest what extra services you may like to propose.
3. Visit a nearby bank branch in your locality and collect information about various types of account available for customers to open as per their requirement.

In the second part of the activity match the information given in column A with the information given in Column B.

S. No.	Column A	Column B
1.	Multiple Option Deposit	It is a temporary pass through account held by a third party during the process of a transaction between two parties unless the transaction is completed.
2.	Savings Account	A kind of deposit scheme introduced by different banks, where the excess amount in the savings bank account is transferred to fixed deposit account and the account holder earns more rate of interest. If the bank receives a cheque for this account and the balance is not sufficient, the amount will be transferred from fixed deposit account to savings bank account to clear the cheque. In short, it gives the account holder the interest of a term deposit with the flexibility of partial withdrawal, whereas, the remaining cash will get better interest.
3.	Current Account	It is also called cumulative deposit scheme. Any resident, individual, association, club, institution/ agency is eligible to open this account in single/joint names. The account can be opened for any period ranging from 6 months to 120 months, in multiple of 1 month for monthly installment. The amount selected for installment at the start of the scheme is payable every month and the number of installments once fixed, cannot be changed. The rate of interest is compounded quarterly and the final amount is paid on maturity.
4.	Fixed Deposit Account	Any resident, individual, association, club, etc., is eligible for this account. It is a kind of modest credit option available to the depositor. Two free cheque books will be issued each year. Internet banking facility will be provided without any charge. Balance enquiry, NEFT, bill payment, mobile recharge, etc., are provided through mobile phones. Students can open this account with zero balance by providing the required documents.
5.	Demat Account	This account can be opened by any resident, individual, association, limited company, religious institution, educational institution, charitable institution, club, etc. Payments can be done unlimited number of times. Funds can be remitted from any part of the country to the corresponding account. Overdraft facility and Internet banking facility are available.

6.	Escrow Account	It is classified as short deposit receipt and fixed deposit receipt *a. Short Deposit Receipt* (i) Banks accept deposits from customers varying from 7 days to a maximum of 10 years. (ii) The period for 'short deposits' can vary from 7 days to 179 days. (iii) The minimum amount that can be deposited under this scheme is Rs. 5 lakh for a period of 7-14 days. *b. Fixed Deposit Receipt* (i) Any resident, individual, association, minor, society, club, etc., is eligible for this account. (ii) The minimum FDR in metro and Urban branches is Rs. 10,000 and in rural and semi-urban and for senior citizens is Rs. 5000. (iii) Interest rate differs from bank to bank depending upon the tenure of the deposits and as bank changes the rate. (iv) Additional interest of 0.50% is offered to senior citizens on deposits placed for a year and above.
7.	Recurring Deposit Account	(i) This account offers stress-free transactions on the shares. (ii) An individual, Non-Resident Indian, foreign institutional investor, foreign national, corporate, trusts, clearing houses, financial institution, clearing member, mutual funds, banks and other depository account. (iii) For opening this account, an applicant requires to fill a form, submit his/her photo along with a photocopy of Voter ID/Passport /Aadhar Card/Driving Licence and a Demat account number will be provided to the applicant immediately after the completion of processing of the application.

CHAPTER 5

EMERGING MODES OF BUSINESS

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- state the meaning of e-business;
- explain the process of online buying and selling as a part of e-business;
- distinguish e-business from traditional business;
- state benefits of switching over to electronic mode;
- explain requirements for a firm's initiation into e-business;
- identify major security concerns of electronic mode of doing business;
- discuss the need for business process outsourcing; and
- appreciate the scope of business process outsourcing.

"Let us do some shopping," Rita woke up Rekha, her friend from the home-village who had come to Delhi during the vacations. "At this hour well past midnight," said Rekha rubbing her eyes, "Who would be sitting with his shop open for you?" "Oh! Perhaps I could not convey it properly. We are not going anywhere! I am talking about online shopping over the internet!" told Rita. "Oh yes! I have heard of online shopping, but have never done any," Rekha said, "What would they be selling over the internet, how will they deliver, What about payment… and why is it that internet has not yet become as popular in the villages? As Rekha was grappling with these questions, Rita had already logged on to one of India's largest online shopping mall.

5.1 Introduction

The way business is done has undergone fundamental changes during the last decade or so. The manner of conducting business is referred to as the 'mode of business,' and, the prefix 'emerging' underlines the fact, that these changes are happening here and now, and, that these trends are likely to continue. In fact, if one were to list the three strongest trends that are shaping business, these would be: (i) digitisation — the conversion of text, sound, images, video, and other content into a series of ones and zeroes that can be transmitted electronically, (ii) outsourcing, and, (iii) inter-nationalisation and globalisation. You will read about international business in Chapter 11. In this chapter, we will be familiarising you with the first two developments, i.e., digitisation (a term from electronics) of business — also referred to as electronic business (e-business), and Business Process Outsourcing (BPO). Before we do so, a brief discussion about the factors responsible for these two new modes of business would be in order.

The newer modes of business are not new business. These are rather simply the new ways of doing business attributable to a number of factors. You are aware that business as an activity is aimed at creating utilities or value in the form of goods and services which the household and industrial buyers purchase for meeting their needs and wants. In an effort to improve the business processes — be it purchase and production, marketing, finance or human resources business managers and business thinkers keep evolving newer and better ways of doing things. Business firms have to strengthen their capabilities of creating utilities and delivering value to successfully meet the competitive pressures and ever-growing demands of consumers for better quality, lower prices, speedier deliveries and better customer care. Besides, the quest for benefitting from emerging technologies means that business as an activity keeps evolving.

5.2 e-Business

If the term business is taken to mean a wide range of activities comprising industry, trade and commerce; e-business may be defined as the conduct of industry, trade and commerce using the computer networks. The network you are most familiar with as a student or consumer is the internet. Whereas internet is a public thorough way, firms use more private, and, hence more secure networks for more effective and efficient management of their internal functions.

e-business versus e-commerce: Though, many a times, the terms e-business and e-commerce are used interchangeably, yet more precise definitions would distinguish between the two. Just as the term 'business' is a broader term than 'commerce', e-business is a more elaborate term and comprises various business transactions and functions conducted electronically, including the more popular gamut of transactions called 'e-commerce.' e-commerce covers a firm's interactions with its customers and suppliers over the internet. e-business includes not only e-commerce, but also other electronically conducted business functions such as production, inventory management, product development, accounting and finance and human resource management. e-business is, therefore, clearly much more than buying and selling over the Internet, i.e., e-commerce.

5.2.1 Scope of e-Business

We have mentioned above that the scope of e-business is quite vast. Almost all types of business functions such as production, finance, marketing and personnel administration as well

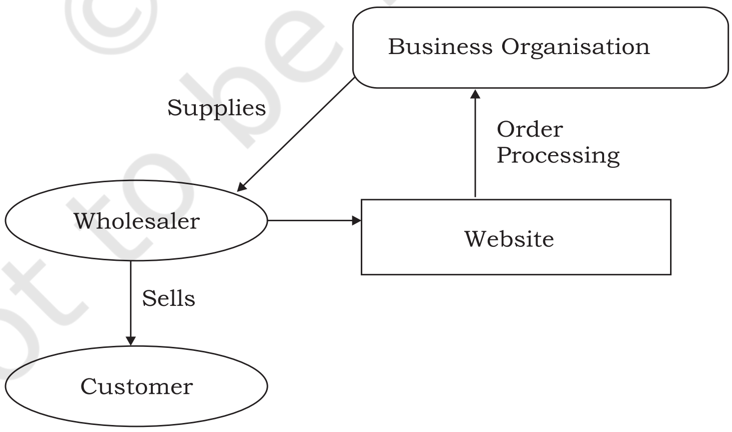


Figure 5.1 Business to Business e-Commerce

as managerial activities like planning, organising and controlling can be carried out over computer networks. The other way of looking at the scope of e-business is to examine it in terms of people or parties involved in electronic transactions. Viewed from this perspective, a firm's electronic transactions and networks can be visualised as extending into three directions viz., (i) B2B which is a firm's interactions with other businesses, (ii) B2C i.e., a firm's interactions with its customers and (iii) intra-B or a firm's internal processes.

A brief discussion of various constituents of e-business and inter- and intra-transactions among them is given as below:

(i) B2B Commerce: Here, both the parties involved in e-commerce transactions are business firms, and, hence the name B2B, i.e., business-to-business (see Figure 5.1). Creation of utilities or delivering value requires a business to interact with a number of other business firms which may be suppliers or vendors of diverse inputs; or else they may be a part of the channel through which a firm distributes its products to the consumers. For example, the manufacture of an automobile requires assembly of a large number of components which in turn are being manufactured elsewhere — within the vicinity of the automobile factory or even overseas. To reduce dependence on a single supplier, the automobile factory has to cultivate more than one vendor for each of the components. A network of computers is used for placing orders, monitoring production and delivery of components, and making payments. Likewise, a firm may strengthen and improve its distribution system by exercising a real time (as it happens) control over its stock-in-transit as well as that with different middlemen in different locations. For example, each consignment of goods from a warehouse and the stock-at-hand can be monitored and replenishments and reinforcements can be set in motion as and when needed. Or else, a customer's specifications may be routed through the dealers to the factory and fed into the manufacturing system for customised production. Use of e-commerce expedites the movement of the information and documents; and of late, money transfers as well.

Historically, the term e-commerce originally meant facilitation of B2B transactions using Electronic Data Interchange (EDI) technology to send and receive commercial documents like purchase orders or invoices.

(ii) B2C Commerce: As the name implies, B2C (business-to-customers) transactions have business firms at one end and its customers on the other end. Although, what comes to one's mind instantaneously is online shopping, it must be appreciated that 'selling' is the outcome of the marketing process. And, marketing begins well before a product is offered for sale and continues even after the product has been sold. B2C commerce, therefore, entails a wide gamut of marketing

Benefits of e-Commerce

1. Business Organisation:
   - (i) Expands the marketplace to national and international markets,
   - (ii) Gradual decline in the cost of operations,
   - (iii) Facilitates 'pull' supply chain management,
   - (iv) Competitive advantage over competitors,
   - (v) Proper time management and support business processes, and
   - (vi) Small firms co-exist with big firms (win-win).
2. Benefits to Consumers and Society
   - (i) Flexibility,
   - (ii) Competitive price/discounts/waive offs,
   - (iii) More options and choices and Customised products,
   - (iv) Quick and Timely delivery (digitised products),
   - (v) Employment potential,
   - (vi) Facilitate e-Auctions and e-Tenders,
   - (vii) Interaction with consumers,
   - (viii) Wider outreach.

activities such as identifying activities, promotion and sometimes even delivery of products (e.g., music or films) that are carried out online. e-Commerce permits conduct of these activities at a much lower cost but high speed. For example, ATM speeds up withdrawal of money.

Customers these days are becoming very choosy and desire individual attention to be given to them. Not only do they require the product features to be tailor-made to suit their requirements, but also the convenience of delivery and payment at their pleasure. With the onset of e-commerce, all this has become a reality.

Further, B2C variant of e-commerce enables a business to be in touch with its customers on round-the-clock basis. Companies can conduct online surveys to ascertain as to who is buying what and what the customer satisfaction level is.

ATM speeds up Withdrawal of Money

e-Commerce greatly facilitates and speeds up the entire B2C process. Withdrawal of one's own money from banks was, for example, a tedious process in the past. One had to go through a series of procedural formalities before he or she was able to get the payment. After the introduction of ATMs, all that is fast becoming a history now. The first thing that occurs is that the customer is able to withdraw his money, and the rest of the back-end processes take place later.

By now, you might have formed the opinion that B2C is a one-way traffic, i.e., from business-to-customers. But do remember that its corollary, C2B commerce is very much a reality which provides the consumers with the freedom of shopping-at-will. Customers can also make use of call centres set up by companies to make toll free calls to make queries and lodge complaints round the clock at no extra cost to them. The beauty of the process is that one need not set up these call centres or help lines; they may be outsourced. We shall discuss this aspect later in the section devoted to Business Process Outsourcing (BPO).

(iii) Intra-B Commerce: Here, parties involved in the electronic transactions are from within a given business firm, hence, the name intra-B commerce. As noted earlier too, one critical difference between e-commerce and e-business is that, e-commerce comprises a business firm's interaction with its suppliers, and distributors/other business firms (hence, the name B2B) and customers (B2C) over the internet. While e-business is a much wider term and also includes the use of intranet for managing interactions and dealings among various departments and persons within a firm. It is largely due to use of intra-B commerce that today it has become possible for the firms to go in for flexible manufacturing. Use of computer networks makes it possible for the marketing department to interact constantly with the production department and get the customised products made as per the requirements of the individual customer. In a similar vein, closer computer-based interactions among the other departments makes it possible for the firm to reap advantages of efficient inventory and cash management, greater utilisation of plant and machinery, effective handling of customers' orders, and effective human resource management.

Just as intercom facilitated voice communication within the office, intranet facilitates multimedia and even 3-D graphic communication among organisational units for well-informed decisions, permitting better coordination, faster decisions and speedier workflows. Take for example, a firm's interactions with its employees, sometimes referred to as B2E commerce. Companies are resorting to personnel recruitment, interviewing and selection, training, development and education via e-commerce (captured in a catch-all phrase 'e-learning'). Employees can use electronic catalogues and ordering forms and access inventory information for better interaction with the customers. They can send field reports via e-mail and the management can have them on real time basis. In fact, Virtual Private Network (VPN) technology would mean that employees do not have to come to office. Instead, in a way the office goes to them and they can work from wherever they are, and at their own speed and time convenience. Meetings can be held online via tele/ video conferencing.

(iv) C2C Commerce: Here, the business originates from the consumer and the ultimate destination is also consumers, thus the name C2C commerce (see Figure 5.2). This type of commerce is best suited for dealing in goods for which there is no established market mechanism, for example, selling used books or clothes either on cash or barter basis. The vast space of the internet allows persons to globally search for potential buyers. Additionally, e-commerce technology provides market system security to such transactions which otherwise would have been missing if the buyers and sellers were to interact in anonymity of one-to-one transactions? An excellent example of this is found at eBay where consumers sell their goods and services to other consumers. To make this activity more secure and robust, several technologies have emerged. Firstly, eBay allows all the sellers and buyers to rate one another. In this manner, future prospective purchasers may see that a particular seller has sold to more than 2,000 customers — all of whom rate the seller as excellent. In another example, a prospective purchaser may see a seller who has previously sold only four times and all four rate the seller poorly. This type of information is helpful. Another technology that has emerged to support C2C activities is that of the payment intermediary. PayPal is a good example of this kind. Instead of purchasing items directly from an unknown, untrusted seller; the buyer can instead send the money to Pay Pal. From there, PayPal notifies the seller that they will hold the money for them until the goods have been shipped and accepted by the buyer.

An important C2C area of interactive commerce can be the formation of consumers' forum and pressure groups. You might have heard of Yahoo groups. Like a vehicle owner in a traffic jam can alert others via message on radio (you must have heard traffic alerts on FM) about the traffic situation of the area he is stuck in; an aggrieved customer can share his experience with a product/service/vendor and warn others by writing just a message and making it known to the entire group. And, it is quite possible that the group pressure might result in a solution of this problem.

From the foregoing discussion concerning scope of e-business, it is clear that e-business applications are varied and many.

e-Business versus Traditional Business

By now, you must have formed an idea as to how e-enabling has radically transformed the mode of doing business. Table 5.1 (page 129) provides a feature on comparison between traditional business and e-business.

A comparative assessment of the features of traditional and e-business as listed in Table 5.1 points towards the distinct benefits and limitations of e-business that we shall discuss in the following paragraphs.

e-commerce makes flexible Manufacturing and Mass Customisation possible

Customised products have traditionally been made to order by craftsmen and have, therefore, been expensive and delivery times have been long. Industrial revolution meant that organisations could engage in mass production and could sell homogeneous products rolled out of the factory at a lower cost due to the economies of scale. Thanks to e-commerce, now organisations can offer customised products/ services at lower costs, that previously were only associated with mass produced commodity items. Here are a few examples:

401(k) Forum (US)	Customises educational content and investment advice based on individual interviews.
Acumin Corp. (US)	Customises vitamin pills specified by using the Internet. Customers fill in lifestyle and health questionnaire.
Dell (US)	Build your own PC.
Green Mountain Energy Resources (US)	Electricity supplier (but not generator). Customers could select sources for their electricity, e.g., hydro, solar, etc.
Levi Jeans (Original Spin) (US)	Tailored jeans service. Web service suspended after complaints by retailers but service now offered through retailers. Offers 49,500 different sizes and 30 styles for a total of nearly 1.5 million options for a cost of just $55. Orders are sent by net and jeans are produced and shipped in 2-3 weeks.
N.V. Nutsbedrijf Westland (Newzealand)	Westland supplies natural gas to many tulip growers in the Netherlands. Computers in the greenhouse help greenhouse owners maintain temperature, CO2 output, humidity, light and other factors in the most cost-efficient manner.
National Bicycle (Japan)	Custom built bicycles within 2/3 days of taking the order.
Simon and Schuster (US)	Teachers can order customised books specifically matched to individual course and student needs. Xerox DocuTech printers are generating in excess of 125,000 customised books a month.
Skyway (US)	Skyway is a logistics company offering whole order delivery. Shipments from multiple origins with different modes of transport can be merged in transit and delivered as a single order with one set of paperwork to the store or consumer.
SmithKline Beecham (US)	Creates customised stop smoking programme for customers. Uses call centre questionnaire to generate a series of personalised communications.

Source: *Adapted from http://www.managingchange.com*

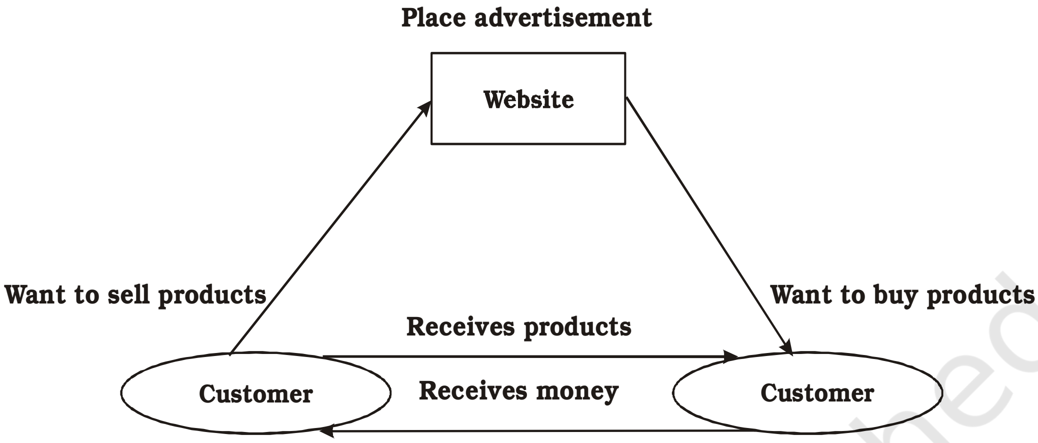


Figure 5.2 Consumer to Consumer e-Commerce (C_2C)

5.3 Benefits of e-Business

(i) Ease of formation and lower investment requirements: Unlike a host of procedural requirements for setting up an industry, e-business is relatively easy to start. The benefits of internet technology accrue to big or small business alike. In fact, internet is responsible for the popularity of the phrase: *'networked individuals and firms are more efficient than networthed individuals.'* This means that even if you do not have much of the investment (networth) but have contacts (network), you can do fabulous business.

Imagine a restaurant that does not have any requirement of a physical space. Yes, you may have an online 'menu' representing the best of cuisines from the best of restaurants the world-over that you have networked with. The customer visits your website, decides the menu, places the order that in turn is routed to the restaurant located closest to his location. The food is delivered and the payment collected by the restaurant staff and the amount due to you as a client solicitor is credited to your account through an electronic clearing system.

(ii) Convenience: Internet offers the convenience of '24 hours × 7 days a week × 365 days' a year business that allowed Rita and Rekha to go for shopping well after midnight. Such flexibility is available even to the organisational personnel whereby they can do work from wherever they are, and whenever they may want to do it. Yes, e-business is truly a business as enabled and enhanced by electronics and offers the advantage of accessing anything, anywhere, anytime.

(iii) Speed: As already noted, much of the buying or selling involves exchange of information that internet allows at

Box A
Some e-Business Applications

e-Procurement: It involves internet-based sales transactions between business firms, including both, "reverse auctions" that facilitate online trade between a single business purchaser and many sellers, and, digital marketplaces that facilitate online trading between multiple buyers and sellers.

e-Bidding/e-Auction: Most shopping sites have 'Quote your price' whereby you can bid for the goods and services (such as airline tickets!). It also includes e-tendering whereby one may submit tender quotations online.

e-Communication/e-Promotion: Right from e-mail, it includes publication of online catalogues displaying images of goods, advertisement through banners, pop-ups, opinion poles and customer surveys, etc. Meetings and conferences may be held by the means of video conferencing.

e-Delivery: It includes electronic delivery of computer software, photographs, videos, books (e-books) and journals (e-journals) and other multimedia content to the user's computer. It also includes rendering of legal, accounting, medical, and other consulting services electronically. In fact, internet provides the firms with the opportunities for outsourcing of a host of Information Technology Enabled Services (ITES) that we will be discussing under business process outsourcing. Now, you can even print the airlines and railway tickets at home!

e-Trading: It involves securities trading, that is online buying and selling of shares and other financial instruments. For example, sharekhan.com is India's largest online trading firm.

the click of a mouse. This benefit becomes all the more attractive in the case of information-intensive products such as softwares, movies, music, e-books and journals that can even be delivered online. Cycle time, i.e., the time taken to complete a cycle from the origin of demand to its fulfilment, is substantially reduced due to transformation of the business processes from being sequential to becoming parallel or simultaneous. You know that in the digital era, money is defined as electronic pulses at the speed of light, thanks to the electronic funds transfer technology of e-commerce.

(iv) Global reach/access: Internet is truly without boundaries. On the one hand, it allows the seller an access to the global market; on the other hand, it affords to the buyer a freedom to choose products from almost any part of the world. It would not be an exaggeration to say that in the absence of internet, globalisation would have been considerably restricted in scope and speed.

(v) Movement towards a paperless society: Use of internet has considerably reduced dependence on paperwork and the attendant 'red tape.' You know that Maruti Udyog does bulk of its sourcing of supplies of materials and components in a paper less fashion. Even the government departments and regulatory authorities are increasingly moving in this direction whereby they allow electronic filing of returns and reports. In fact, e-commerce tools are effecting the administrative reforms aimed at speeding up the process of granting permissions, approvals and licences. In this respect, the provisions of Information Technology Act 2000 are quite noteworthy.

5.4 Limitations of e-Business

e-business is not all that rosy. Doing business in the electronic mode suffers from certain limitations. It is advisable to be aware of these limitations as well.

(i) Low personal touch: High-tech it may be, e-business, however, lacks warmth of interpersonal interactions. To this extent, it is relatively less suitable mode of business in respect of product categories requiring high personal touch such as garments, toiletries, etc.

(ii) Incongruence between order taking/giving and order fulfilment speed: Information can flow at the click of a mouse, but the physical delivery of the product takes time. This incongruence may play on the patience of the customers. At times, due to technical reasons, web sites take unusually long time to open. This may further frustrate the user.

(iii) Need for technology capability and competence of parties to e-business: Apart from the traditional 3R's (**R**eading, W**R**iting, and A**R**ithmetic), e-business requires a fairly high degree of familiarity of the parties with the world of computers. And, this requirement is responsible for what is known as digital divide, that is the division of society on the basis of familiarity and non-familiarity with digital technology.

(iv) Increased risk due to anonymity and non-traceability of parties: Internet transactions occur between cyber personalities. As such, it becomes difficult to establish the identity of the parties. Moreover, one does not know even the location from where the parties may be operating. It is riskier, therefore, transacting through internet. e-business is riskier also in the sense that there are additional hazards of impersonation (someone else may transact in your name) and leakage of confidential information such as credit card details. Then, there also are problems of 'virus,' and 'hacking,' that you must have heard of. If not, we will be dealing with security and safety concerns of online business.

(v) People resistance: The process of adjustment to new technology and new way of doing things causes stress and a sense of insecurity. As a result, people may resist an organisation's plans of entry into e-business.

(vi) Ethical fallouts: "So, you are planning to quit, you may as well quit right now", said the HR manager showing her a copy of the e-mail that she had written to her friend. Sabeena was both shocked and stunned as to how her boss got through to her e-mail account. Nowadays, companies use an 'electronic eye' to keep track of the computer files you use, your e-mail account, the websites you visit etc. Is it ethical?

Table 5.1 Difference between Traditional and e-Business

Basis of distinction	Traditional business	e-business
Ease of formation	Difficult	Simple
Physical presence	Required	Not required
Locational requirements	Proximity to the source of raw materials or the market for the products	None
Cost of setting up	High	Low as no requirement of physical facilities
Operating cost	High due to fixed charges associated with investment in procurement and storage, production, marketing and distribution facilities	Low as a result of reliance on network of relationships rather than ownership of resources
Nature of contact with the suppliers and the customers	Indirect through intermediaries	Direct
Nature of internal communication	Hierarchical - from top level management to middle level management to lower level management to operatives	Non-hierarchical, allowing direct vertical, horizontal and diagonal communication
Response time for meeting customers'/internal requirements	Long	Instantaneous
Shape of the organisational structure	Vertical/tall, due to hierarchy or chain of command	Horizontal/flat due to directness of command and communication.
Business processes and length of the cycle	Sequential precedence-succession relationship, i.e., purchase - production/operation - marketing - sales. The, business process cycle is, therefore, longer	Simultaneous (concurrence) different processes. Business process cycle is, therefore, shorter
Opportunity for inter-personal touch	Much more	Less
Opportunity for physical pre-sampling of the products	Much more	Less. However, for digitable products such an opportunity is tremendous. You can pre-sample music, books, journals, software, videos, etc.
Ease of going global	Less	Much, as cyber space is truly without boundaries

Government patronage	Shrinking	Much, as IT sector is among the topmost priorities of the government
Nature of human capital	Semi-skilled and even unskilled manpower needed.	Technically and professionally qualified personnel needed
Transaction risk	Low due to arm's length transactions and face-to-face contact.	High due to the distance and anonymity of the parties

Despite limitations, e-commerce is the way

It may be pointed out that most of the limitations of e-business discussed above are in the process of being overcome. Websites are becoming more and more interactive to overcome the problem of 'low touch.' Communication technology is continually evolving to increase the speed and quality of communication through internet. Efforts are on to overcome the digital divide, for example, by resorting to such strategies as setting up of community telecentres in villages and rural areas in India with the involvement of government agencies, NGOs and international institutions. In order to diffuse e-commerce in all nooks and corners, India has undertaken about 150 such projects.

In view of the above discussion, it is clear that e-business is here to stay and is poised to reshape the businesses, governance and the economies. It is, therefore, appropriate that we familiarise ourselves with how e-business is conducted.

5.5 Online Transactions

Operationally, one may visualise three stages involved in online transactions. Firstly, the pre-purchase/sale stage including advertising and information-seeking; secondly, the purchase/sale stage comprised of steps such as price negotiation, closing of purchase/sales deal and payment; and thirdly, the delivery stage (see Figure 5.2). It may be observed from Figure 5.2 that, except the stage relating to delivery, all other stages involve flow of information. The information is exchanged in the traditional business mode too, but at severe time and cost constraints. In face-to-face interaction in traditional business mode, for example, one needs to travel to be able to talk to the other party, requiring travel effort, greater time and costs. Exchange of information through the telephone is also cumbersome. It requires simultaneous presence of both the parties for verbal exchange of information. Information can be transmitted by post too, but this again is quite a time consuming and expensive process. Internet comes in as the fourth channel which is free from

Information Technology Act 2000 paves way for Paperless Society

Below are given some of the provisions of Information Technology Act 2000 that have made it possible to have paper less dealings in the business world as well as in the government domain.

Legal recognition of electronic records (Section 4): Where any law provides that information or any other matter shall be in writing or in the typewritten or printed form, then, notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied if such information or matter is rendered or made available in an electronic form; and accessible so as to be usable for a subsequent reference.

Legal recognition of digital signatures (Section 5): Where any law provides that information or any other matter shall be authenticated by affixing the signature or any document shall be signed or bear the signature of any person, hence notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied, if such information or matter is authenticated by means of digital signature affixed in such a manner as may be prescribed by the Central Government.

Use of electronic records and digital signatures in Government and its agencies (Section 6-1): Where any law provides for the filing of any form, application or any other document with any office, authority, body or agency owned or controlled by the appropriate Government in a particular manner; the issue or grant of any licence, permit, sanction or approval by whatever name called in a particular manner; the receipt or payment of money in a particular manner, then, notwithstanding anything contained in any other law for the time being in force, such requirement shall be deemed to have been satisfied if such filing, issue, grant, receipt or payment, as the case may be, is effected by means of such electronic form as may be prescribed by the appropriate Government.

Retention of electronic records (Section 7-1): Where any law provides that documents, records or information shall be retained for any specific period, then, that requirement shall be deemed to have been satisfied if such documents, records or information are retained in the electronic form.

Source: *Information Technology Act, 2000*

most of the problems referred to above. In the case of information-intensive products and services such as software and music, even delivery can take place online.

What is described here is the process of online trading from a customer's standpoint. We will be discussing the seller's perspective in the paragraphs on resource requirements for e-business. So, are you ready with the shopping list or would you like to rely on your instincts as you take a tour of the shopping mall? Let us follow Rita and Rekha browsing indiatimes.com.

(i) Registration: Before online shopping, one has to register with the online vendor by filling-up a registration form. Registration means that you have an 'account' with the online vendor. Among various details that need to be filled in is a 'password' as the sections relating to your 'account', and 'shopping cart' are password protected. Otherwise, anyone can login using your name and shop in your name. This can put you in trouble.

(ii) Placing an order: You can pick and drop the items in the shopping cart. Shopping cart is an online record of what you have picked up while browsing the online store. Just as in a physical store you can put in and take items out of your cart, likewise, you can do so even while shopping online. After being sure of what you want to buy, you can 'checkout' and choose your payment options.

(iii) Payment mechanism: Payment for the purchases through online shopping may be done in a number of ways:

- **Cash-on Delivery (CoD):** As is clear from the name, payment for the goods ordered online may be made in cash at the time of physical delivery of goods.
- **Cheque:** Alternatively, the online vendor may arrange for the pickup of the cheque from the customer's end. Upon realisation, the delivery of goods may be made.
- **Net-banking Transfer:** Modern banks provide to their customers the facility of electronic transfer of funds over the Internet using Immediate Payment Services (IMPS), NEFT and RTGS. In this case, therefore, the buyer may transfer the amount for the agreed price of the transaction to the account of the online vendor who may, then, proceed to arrange for the delivery of goods.
- **Credit or Debit Cards:** Popularly referred to as 'plastic money,' these cards are the most widely used medium for online transactions. In fact, about 95 per cent of online consumer transactions are executed with a credit card. Credit card allows its holder to make purchase on credit. The amount due from the card holder to the online seller is assumed by the card issuing bank, who later transfers the amount involved in the transaction to the credit of the seller. Buyer's account is debited, who often enjoys the freedom to deposit the amount in instalments and at his convenience. Debit card allows its holder to make purchases through it to the extent of the amount lying in the corresponding account. The moment any transaction is made, the amount due as payment is deducted electronically from the card.

To accept credit card as an online payment type, the seller first needs a secure means of collecting credit card information from its customer. Payments through credit cards can be processed either manually, or through an online authorisation system, such as SSL Certificate (see box on, History of e-commerce).

- **Digital Cash:** This is a form of electronic currency that exists only in cyberspace. This type of currency has no real physical properties, but offers the ability to use real currency in an electronic format. First you need to pay to a bank (vide cheque, draft, etc.) an amount equivalent to the digital cash that you want to get issued in your favour. Then the bank dealing in e-cash will send you a special software (you can download on your hard disk) that will allow you to draw digital cash from your account with the bank. You may then use the digital funds to make purchases over the web.

5.6 Security and Safety of e-Transactions: e-Business Risks

Online transactions, unlike arm's length transactions in physical exchange, are prone to a number of risks. Risk refers to the probability of any mishappening that can result into financial, reputational or psychological losses to the parties involved in a transaction. Because of greater probability of such risks in the case of online transactions, security and safety issues becomes the most crucial concern in e-business. One may broadly discuss these issues under three headings: transaction risks, data storage and transmission risks, and threat to intellectual property and privacy risks.

(i) Transaction risks: Online transactions are vulnerable to the following types of transaction risks:

- Seller denies that the customer ever placed the order or the customer denies that he ever placed the order. This may be referred to as '*default on order taking/giving.*'

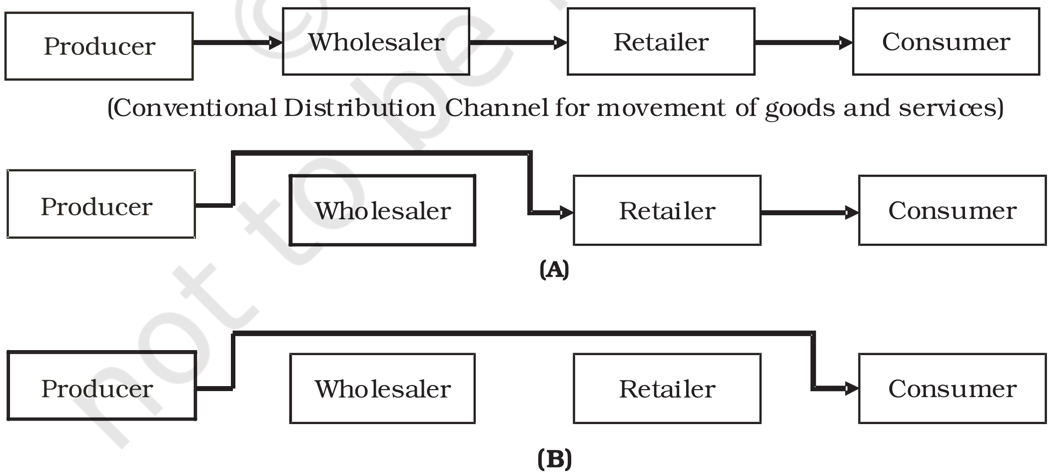


Figure 5.3 (A) and (B) : Distribution channel gets shortened by e-Business

- The intended delivery does not take place, goods are delivered at wrong address, or goods other than ordered may be delivered. This may be regarded as '*default on delivery*'.
- Seller does not get the payment for the goods supplied whereas the customer claims that the payment was made. This may be referred to as '*default on payment*'.

Thus, in e-business risk may arise for the seller or the buyer on account of default on order taking/giving, delivery as well as payment. Such situations can be averted by providing for identity and location/address verification at the time of registration, and obtaining authorisation as to the order confirmation and payment realisation. For example, in order to confirm that the customer has correctly entered his details in the registration form, the seller may verify the same from the 'cookies'. Cookies are very similar to the caller ID in telephones that provide telemarketers with such relevant information as: the consumer's name, address and previous purchase payment record. As for customer's protection from anonymous sellers, it is always advisable to shop from well-established shopping sites. While allowing advertisers to sell their products online, these sites assure customers of the sellers' identities, locations and service records. Sites such as eBay even provide for rating of the sellers. These sites provide protection to the customers against default on delivery and reimburse the payments made up to some extent.

As for the payments, we have already seen that in almost 95 per cent of the cases people use credit cards for their online purchases. At the time of confirming the order, the buyer is required to furnish the details such as the card number, card issuer and card validity online. These details may be processed offline; and only after satisfying himself or herself about the availability of the credit limits, etc., the seller may go ahead with the delivery of goods. Alternatively, e-commerce technology today permits even online processing of the credit card information. For protecting the credit card details from being misused, shopping malls these days use the encryption technology such as Netscape's Secure Sockets Layer (SSL). You can gain some information about SSL from box on history of e-commerce. In the succeeding section, we will familiarise you with the encryption or cryptography — an important tool used for safeguarding against data transmission risks in online transactions.

(ii) Data storage and transmission risks: Information is power indeed. But think for a moment if the power goes into the wrong hands. Data stored in the systems and en-route is exposed to a number of risks. Vital information may be stolen or modified to pursue some selfish motives or simply for fun/adventure. You must have heard of 'virus' and 'hacking'. Do you know the full form of the acronym 'VIRUS?' It means **V**ital **I**nformation **U**nder **S**iege. Actually, virus is a program (a series of commands) which replicates itself on the other computer systems. The effect of computer viruses can range from mere annoyance in terms of some on-screen display (Level-1 virus), disruption of functioning (Level-2 virus) damage to target data files (Level-3 virus), to complete destruction of the system (Level-4 virus). Installing and timely updating anti-virus programmes and scanning the files and disks with them provides protection to your data files, folders and systems from virus attacks.

Data may be intercepted in the course of transmission. For this, one may use *cryptography*. It refers to the art of protecting information by transforming it (encrypting it) into an unreadable format called 'cyphertext'. Only those who possess a secret key can decipher (or decrypt) the message into 'plaintext'. This is similar to using 'code words' with some one so that others do not understand your conversation.

(iii) Risks of threat to intellectual property and privacy: Internet is an open space. Once the information is available over the internet, it moves out of the private domain. It then becomes difficult to protect it from being copied. Data furnished in the course of online transactions may be supplied to others who may start dumping a host of advertising and promotional literature into your e-mail box. You are then at the receiving end, with little respite from receiving junk mails.

5.7 Resources Required for Successful e-business Implementation

Setting up of any business requires money, men and machines (hardware). For e-business, you require additional resources for developing, operating, maintaining and enhancing a website where 'site' means location and 'web' means world wide web (www). Simply speaking, a website is a firm's location on the world wide web. Obviously, website is not a physical location. Rather, it is an online embodiment of all the content that a firm may like to provide to others.

5.8 Outsourcing: Concept

Outsourcing is yet another trend that is radically reshaping business. It refers to a long-term contracting out generally the non-core and of late even some of the core activities to captive or third party specialists with a view to benefitting from their experience, expertise, efficiency and, even investment.

This simple definition leads one to the salient features of the concept that are not peculiar to an industry/ business or country, but have become a global phenomenon.

(i) Outsourcing involves contracting out: Literally, outsourcing means to source from outside what you have hitherto been doing in-house. For example, most companies have so far appointed their own sanitation staff for maintaining neatness, cleanliness and overall housekeeping of their premises.

That is, sanitation and housekeeping functions were being performed in-house. But of late, many companies have started outsourcing these activities, i.e., they have entrusted outside agencies to perform these activities for their organisations on a contractual basis.

(ii) Generally non-core business activities are outsourced: Sanitation and housekeeping functions are non-core for most organisations. Of course, for municipalities and sanitations services providers, these activities comprise the core of their business activity. Housekeeping is a core activity for a hotel. In other words, depending upon what business a company is in, there will be some activities that are central and critical to its basic business purpose. Other activities may be regarded as secondary or incidental to fulfilling that basic purpose. The purpose of a school, for example, is to develop a child by means of curricular and co-curricular activities. Clearly, these activities comprise the 'core' activities. Running a cafeteria/canteen or a book store is non-core activity for a school.

As the organisations venture to experiment with outsourcing, they may initially outsource only the non-core activities. But later on, as they become comfortable with managing interdependencies, they may start getting even the core activities performed by the outsiders. For example, a school may tie-up with some computer training institute to impart computer education to its students.

(iii) Processes may be outsourced to a captive unit or a third party: Think of a large multinational corporation that deals in diverse products and markets them to a large number of countries. A number of processes such as recruitment, selection, training, record and payroll (Human Resources), management of accounts receivable and accounts payable (accounting and finance), customer support/grievance handling /troubleshooting (marketing) are common to all its subsidiaries operating in different countries. If these processes could be centralised and parcelled out to a business unit created especially for this purpose, this would result in avoidance of duplication of resources, realisation of efficiency and economy's performance of same activity on a large scale at one or a few select locations, thereby resulting in substantial reduction in costs. Clearly, therefore, if the task of performing some activity internally is sufficiently large, it may be beneficial for the firm to have a captive service provider, i.e., a service provider set up for providing services of a given kind to only one firm. General Electric (GE) is, for instance, the largest captive BPO unit in India for providing certain kinds of services to the parent company in the United States as well as to its subsidiaries in other countries. Or else, these processes may be parcelled out to third party service providers who operate independently in the market and provide services to other firms too.

Figure 5.4 provides a synoptical view of how a firm can outsource some of its activities to the captive and third

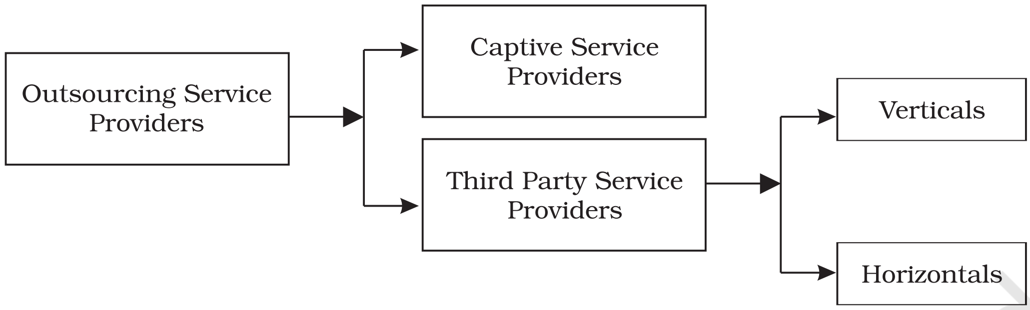


Figure 5.4 Types of Outsourcing Service Providers

party service providers. The hired party service providers are the persons/firms which specialise in some processes such as Human Resource Management (HRM) and provide their services to a wide base of clients, cutting across industries. Such service providers are called 'horizontals' in the outsourcing terminology. Else, they may specialise in one or two industries and scale up to doing a number of processes from non-core to core. These are called 'verticals.' As the service providers mature, they move simultaneously horizontal and vertical.

The most important reason underlying the use of outsourcing is to benefit from the expertise and experience of others. Institutions like schools, companies and hospitals can outsource the cafeteria activity to the catering and nutrition firms for whom these activities comprise the core or heart of their operations. The idea of outsourcing is valuable as you tend to gain not only in terms of their expertise and experience and the resultant efficiency, but it also allows you to limit your investment and focus attention to what your core processes are.

Little wonder that outsourcing is fast becoming an emerging mode of business. Firms have started increasingly outsourcing one or more of their processes which can be more efficiently and effectively carried out by others. What qualifies outsourcing as an emerging mode of business is its increasing acceptance as a fundamental business policy and philosophy, as opposed to the earlier philosophy of 'doing it all by yourself '.

5.8.1 Scope of Outsourcing

Outsourcing comprises four key segments: contract manufacturing, contract research, contract sales and informatics (see Figure 5.5).

The term outsourcing has more popularly come to be associated with IT-enabled services or Business Process Outsourcing (BPO). In fact, even more popular term is 'call centres' providing customer-oriented voice based services. About 70 per cent of the BPO industry's revenue comes from call-centers, 20 per cent from high-volume, low-value data work and the remaining 10 per cent from higher-value information work. 'Customer Care' accounts for the bulk of the call centre activities with 24 hours × 7 days handling of in-bound (customer queries and grievances) and out-bound (customer surveys, payment follow-up and telemarketing) traffic. Figure 5.5 outlines various types of outsourcing activities.

5.8.2 Need for Outsourcing

Necessity, they say, is the mother of all inventions. This can be said to be true even in case of the idea of outsourcing. As discussed in the introduction to the chapter, global competitive pressures for higher quality products at lower costs, ever demanding customers, and emerging technologies are the three major drivers causing a rethink or re-look at business processes. These may be regarded as factors responsible for the continuing emergence of outsourcing as a mode of business. In fact, today outsourcing is being resorted to not out of compulsion,

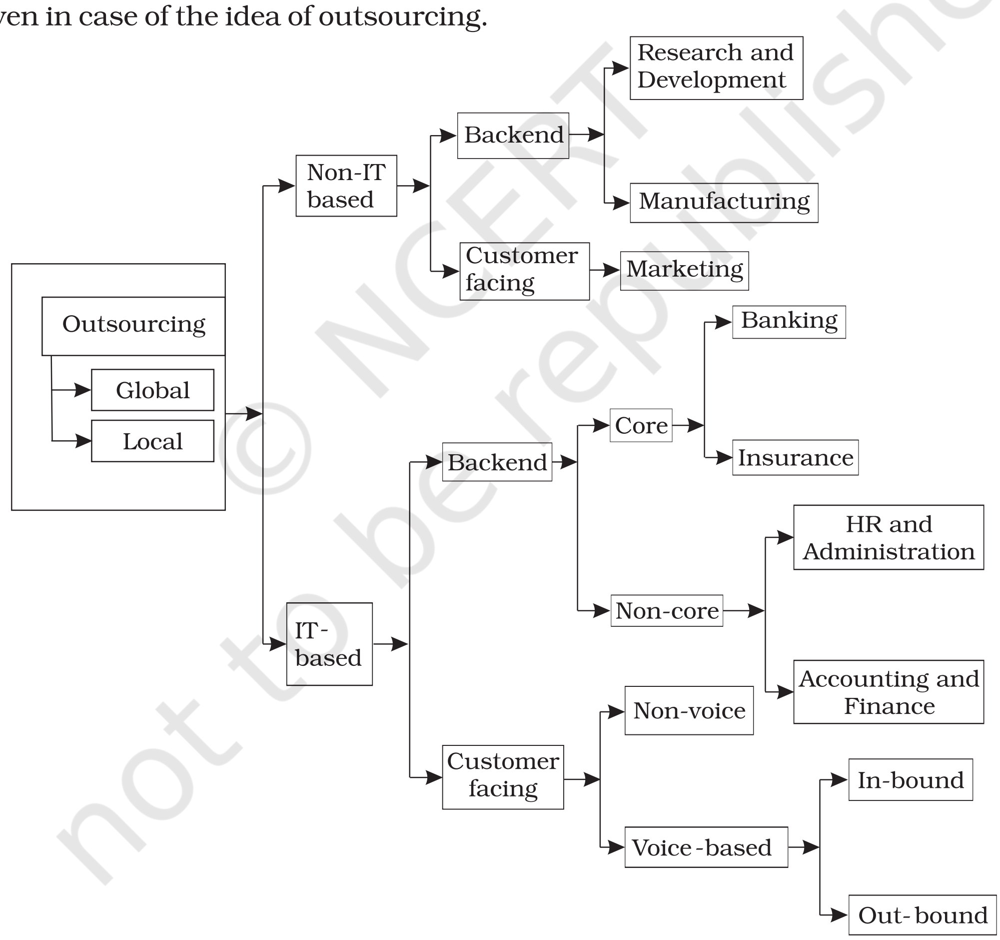


Figure 5.5 Anatomy of Outsourcing

but also out of choice. Some of the major reasons (and also benefits) of outsourcing are discussed below.

(i) Focusing of attention: You may be good at doing so many things in academics and extra-curricular activities, yet you would be better off by focusing your limited time and money on just a few things for better efficiency and effectiveness. Likewise, business firms are realising the usefulness of focusing on just a few areas where they have distinct capability or core competence, and contracting out the rest of the activities to their outsourcing partners. You are aware, that, in order to create utilities or value, a business engages in a number of processes, viz., purchase and production, marketing and sales, R&D, accounting and finance, HR and administration etc. Firms need to define or redefine themselves. They, for example, need to consider as to whether they would like to be called a manufacturing or marketing organisation. Such a way of delimiting the scope of business enables them to focus their attention and resources on select activities for better efficiency and effectiveness.

(ii) Quest for excellence: You are aware of the benefits of division of labour and specialisation. Outsourcing enables the firms to pursue excellence in two ways. One, they excel themselves in the activities that they can do the best by virtue of limited focus. And, they excel by extending their capabilities through contracting out the remaining activities to those who excel in performing them. In the quest for excellence, it is necessary not only to know what you would like to focus on, but also what you would like others to do for you.

(iii) Cost reduction: Global competitiveness necessitates not only global quality, but also global competitive pricing. As the prices turn southwards due to competitive pressures, the only way to survival and profitability is cost reduction. Division of labour and specialisation, besides improving quality, reduces cost too. This happens due to the economies of large scale accruing to the outsourcing partners as they deliver the same service to a number of organisations. Differences in prices of factors of production across the countries are also a factor contributing to cost reduction. For example, India is a preferred destination for global outsourcing of Research and Development, manufacturing, software development and IT enabled services (ITES) because of large scale availability of required manpower at lower costs.

(iv) Growth through alliance: To the extent you can avail of the services of others, your investment requirements are reduced, others have invested in those activities for you. Even if you may like to have a stake in the business of your outsourcing partners, you profit from not only the low-cost and better quality services provided by them to you but also by virtue of a share in the profit from the overall business they do. Therefore, you can expand rapidly as the same amount of investible funds result in creation of a large number of businesses. Apart from financial returns, outsourcing facilitates inter-organisational knowledge sharing and collaborative learning. This may also explain the reasons why the firms today are outsourcing not only their routine, non-core processes, but also seeking to benefit from outsourcing such strategic and core processes as Research and Development.

(v) Fillip to economic development: Outsourcing, more so offshore outsourcing, stimulates entrepreneurship, employment and exports in the host countries (i.e., the countries from where outsourcing is done). In India in the IT sector alone, for example, there has been such a tremendous growth of entrepreneurship, employment and exports that today we are the undisputed leaders as far as global outsourcing in software development and IT-enabled services are concerned. Presently, we have 60 per cent of the $150 billion (1 billion = Rs. 100 crores) global outsourcing share in the informatics sector.

5.8.3 Concerns over Outsourcing

It will not be out of place to be aware of some of the concerns that outsourcing is besieged with.

(i) Confidentiality: Outsourcing depends on sharing a lot of vital information and knowledge. If the outsourcing partner does not preserve the confidentiality, and, say, for example, passes it on to competitors, it can harm the interest of the party that outsources its processes. If outsourcing involves complete processes/products, there is a further risk of the outsourcing partner starting up a competitive business.

(ii) Sweat-shopping: As the firms that outsource seek to lower their costs, they try to get maximum benefit from the low-cost manpower of the host countries. Moreover, it is observed that whether in the manufacturing sector or the IT-sector, what is outsourced is the kind of components or work that does not much build the competency and capability of the outsourcing partner beyond the skills needed to comply with a rigidly prescribed procedure/ method. So, what the firm that go in for outsourcing look for is the 'doing' skills rather than development of the 'thinking' skills.

(iii) Ethical concerns: Think of a shoe company that, in order to cut costs, outsources manufacturing to a developing country where they use child labour/women in the factories. Back home, the company cannot do so due to stringent laws forbidding use of child labour. Is cost cutting by using child labour in countries where it is not outlawed or where the laws are 'weak', ethical? Similarly, is it ethical to outsource the work to countries where there exists wage-discrimination on the basis of sex of the worker?

(iv) Resentment in the home countries: In the course of contracting out manufacturing, marketing, Research and Development or IT-based services, what is ultimately contracted out is 'employment' or jobs. This may cause resentment back in the home country (i.e., the country from which the job is being sourced out) particularly if the home country is suffering from the problem of unemployment.

The aforementioned concerns, however, do not seem to matter much as the global outsourcing continues to flourish. As India emerges as a global outsourcing hub, the industry is forecast to explode at exponential rates — from 23,000 people and $ 10 million per annum in 1998 to over a million people and revenues in excess of $ 20 billion by 2008.

Key Terms

e-Business	e-Commerce	Browser
Virus	Secure Sockets Layer (SSL)	Online trading
e-Trading	e-Procurement	e-Bidding
e-Cash	Business Process Outsourcing	Call Centres
Verticals	Horizontals	Captive BPO units
Sweat-shopping		

SUMMARY

The world of business is changing. e-business and outsourcing are the two most obvious expressions of this change. The trigger for the change owes its origin to both internal and external forces. Internally, it is the business firm's own quest for improvement and efficiency that has propelled it into e-business and outsourcing. Externally, the ever mounting competitive pressures and ever demanding customers have been the force behind the change.

Electronic mode of doing business, or e-business as it is referred to, presents the firm with promising opportunities for anything, anywhere and anytime to its customers, thereby, dismantling the time and space/locational constraints on its performance. Though e-business is high-tech, it suffers from the limitation of being low in personal touch. The customers as a result do not get attended to on an interpersonal basis. Besides, there are concerns over security of e-transactions and privacy of those who transact business over the internet. The benefits of e-commerce also seem to have accrued unevenly across countries and across regions within a country.

Apart from becoming digital, the firms are also resorting to a departure from the erstwhile 'do it all by yourself' mindset. They are increasingly contracting out manufacturing, R and D as well as of business processes irrespective of whether these are IT enabled or not. India is riding high on the global outsourcing business and has gained considerably in terms of employment generation, capability building and contribution to exports and GDP.

Together, the two trends of e-business and outsourcing are reshaping the way business is and will be conducted. Interestingly, both e-business and outsourcing are continuing to evolve, and that is why these are referred to as the emerging modes of business.

EXERCISES

Multiple Choice Questions

Tick mark (✓) the most appropriate answer to the following questions

1. e-commerce does not include
   a. A business's interactions with its suppliers
   b. A business's interactions with its customers
   c. Interactions among the various departments within the business
   d. Interactions among the geographically dispersed units of the business

2. Outsourcing
   a. Restricts only to the contracting out of Information Technology Enabled Services (ITES)
   b. Restricts only to the contracting out of non-core business processes
   c. Includes contracting out of manufacturing and R&D as well as service processes — both core and non-core — but restricts only to domestic territory
   d. Includes off-shoring
3. The payment mechanism typical to e-business
   a. Cash on Delivery (CoD)
   b. Cheques
   c. Credit and Debit Cards
   d. e-Cash
4. A Call Centre handles
   a. Only in-bound voice based business
   b. Only out-bound voice based business
   c. Both voice based and non-voice based business
   d. Both customer facing and back-end business
5. It is not an application of e-business
   a. Online bidding
   b. Online procurement
   c. Online trading
   d. Contract R&D

Short Answer Questions (50 Words)

1. State any three differences between e-business and traditional business.
2. How does outsourcing represent a new mode of business?
3. Describe briefly any two applications of e-business.
4. What are the ethical concerns involved in outsourcing?
5. Describe briefly the data storage and transmission risks in e-business.

Long Answer Questions

1. Why are e-business and outsourcing referred to as the emerging modes of business? Discuss the factors responsible for the growing importance of these trends.
2. Elaborate the steps involved in on-line trading.
3. Evaluate the need for outsourcing and discuss its limitations.

4. Discuss the salient aspects of B2C commerce.
5. Discuss the limitations of electronic mode of doing business. Are these limitations severe enough to restrict its scope? Give reasons for your answer.

Projects/Assignments

1. Compare and contrast the products and their prices available on the internet and in retail shops. Is the quality, customer satisfaction and other factors the same?
2. Study any business unit/company which is using e-commerce, e-business as a way of doing business. Interview some people working there and find out the advantages in practical business in terms of its costs also.

CHAPTER 6

SOCIAL RESPONSIBILITIES OF BUSINESS AND BUSINESS ETHICS

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- explain the concept of social responsibility;
- discuss the need for social responsibility;
- identify the social responsibility towards different interest groups;
- analyse the relationship between business and environmental protection; and
- define the concept of business ethics and state the elements of business ethics.

Mani is a young newspaper reporter and has been writing for almost six months on malpractices by business enterprises including such issues as misleading advertisements, supply of adulterated products, poor working conditions, environmental pollution, bribing government officials, and so on. He has started believing that business people tend to do anything to mint money. He happens to take an interview of Mr. Raman Jhunjhunwala, chairman of a leading truck manufacturing company which is known for its fair dealing with customers, employees, investors as well as other social groups. Through this interview, Mani develops the understanding that it is possible for a business enterprise to be socially responsible and ethically upright and, at the same time, be highly profitable. He then gets busy with studying more about the social responsibility of business and business ethics.

6.1 Introduction

A business enterprise should do business and earn money in ways that fulfill the expectations of the society. Every individual living in society has certain obligations towards society. He has to respect social values and norms of behaviour. A business enterprise is permitted by society to carry on industrial or commercial activities and thereby earn profits. But it is obligatory on part of the business enterprise not to do anything, that is undesirable from society's point of view. Manufacture and sale of adulterated goods, making deceptive advertisements, not paying taxes which are due, polluting the environment and exploiting workers are some examples of socially undesirable practices which may increase the profit of enterprises but which have adverse effect on society at large. On the other hand, supplying good quality goods, creating healthy working conditions, honestly paying taxes prevention/installing pollution devices in the factory, and sincerely attending to customer complaints are examples of socially desirable practices which improve the image of enterprises and also make them profitable. In fact, it is through socially responsible and ethically upright behaviour that business enterprises can get durable success.

6.2 Concept of Social Responsibility

Social responsibility of business refers to its obligation to take those decisions and perform those actions which are desirable in terms of the objectives and values of our society. The assumption of social responsibilities by business enterprises implies that they respect the aspirations of society and would try their best to contribute to the achievement of these aspirations along with their profit interests. This idea is in contrast to the common notion that business exists only for maximising profits for its owners and it is irrelevant to talk of public good. It follows that a responsible business, and indeed any responsible member of society, must act with due concern for the effects on the lives of other people.

In this sense, social responsibility is broader than legal responsibility of business. Legal responsibility may be fulfilled by mere compliance with the law. Social responsibility is more than that. It is a firm's recognition of social obligations even though not covered by law, along with the obligations laid down by law. In other words, social responsibility involves an element of voluntary action on the part of business people for the benefit of society.

6.3 Need for Social Responsibility

What is the right thing to do when it comes to social responsibility? Should a business enterprise be run for the benefit of its owners who may desire to get as much profit as is possible or else, it needs to be responsible for serving the interest of other sections of society such as customers, employees, suppliers, government and community? The very concept of social responsibility implies that it is essentially an ethical issue, since it involves the question of what is morally right or wrong in relation to the firm's responsibilities. Social responsibility also has an element of voluntary action on the part of the business person who may feel free to perform or not to perform such responsibilities. They may also exercise their freedom for deciding the extent to which they would like to serve various sections of society. In fact, all business people do not feel equally responsible towards society. There has been a debate, for some time now whether business should assume social responsibilities or not. Some people strongly believe that a firm's only social

Corporate Social Responsibility

Corporate sustainability refers to the role that companies can play in meeting the agenda of sustainable development and entails a balanced approach to economic progress, social progress and environmental protection.

There is no single universally accepted definition of CSR, each definition that currently exists underpins the impact that businesses have on society at large and the societal expectations of them.

i. The European Commission defines CSR as "the responsibility of enterprises for their impacts on society".
ii. The World Business Council for Sustainable Development defines CSR as "the continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families, as well as, of the community and society at large".
iii. The United Nations Industrial Development Organisation defines "Corporate social responsibility" as a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is generally understood as being the

way through which a company achieves a balance of economic, environmental and social imperatives while at the same time addressing the expectations of shareholders and stakeholders. In this sense, it is important to draw a distinction between CSR, which can be strategic business management concept and charity, sponsorships or philanthropy. Even though the latter can also make a valuable contribution to poverty reduction, it will directly enhance the reputation of a company and strengthen its brand, the concept of CSR clearly goes beyond that".

In India, the concept of CSR is governed by Clause 135 of the Companies Act, 2013, which was passed by both the Houses of the Parliament, and had received the assent of the President of India on 23 August 2013.

The CSR provisions within the Act is applicable to companies with an annual turnover of 1,000 crore and more, or a net worth of Rs. 500 crore and more, or a net profit of Rs. 5 crore and more.

1. The new rules, which are applicable from the fiscal year 2014-15 onwards, also require companies to setup a CSR committee consisting of their board members, including at least one independent director.
2. The Act encourages companies to spend at 2% of their average net profit in the previous three years on CSR activities.
3. The indicative activities, which can be undertaken by a company under CSR, have been specified under Schedule VII of the Act.
4. Only CSR activities undertaken in India will be taken into consideration.
5. Activities meant exclusively for employees and their families will not qualify under CSR.

responsibility is towards its owners. Some others, however, hold an opposite view and argue that the firm has a social responsibility to serve all sections of society who are affected by its decisions and actions. It would be useful to understand the arguments offered both in favour of and against the assumption of social responsibilities by business.

6.3.1 Arguments for Social Responsibility

(i) Justification for existence and growth: Business exists for providing goods and services to satisfy human needs. Though, profit motive is an important justification for undertaking business activity, it should be looked upon as an outcome of service to the people. In fact, the prosperity and growth of business is possible only through continuous service to society. Thus, assumption of social responsibility by business provides justifications for its existence and growth.

(ii) Long-term interest of the firm: A firm and its image stands to gain maximum profits in the long run when it has its highest goal as 'service to society'. When increasing number of members of society — including workers, consumers, shareholders, government officials, feel that business enterprise is not serving its best interest, they will tend to withdraw their cooperation to the enterprise concerned. Therefore, it is in its own interest if a firm fulfills its social responsibility. The public image of any firm would also be improved when it supports social goals.

(iii) Avoidance of government regulation: From the point of view of a business, government regulations are undesirable because they limit freedom. Therefore, it is believed that businessmen can avoid the problem of government regulations by voluntarily assuming social responsibilities, which helps to reduce the need for new laws.

(iv) Maintenance of society: The argument here is that laws cannot be passed for all possible circumstances. People who feel that they are not getting their due from the business may resort to anti-social activities, not necessarily governed by law. This may harm the interest of business itself. Therefore, it is desirable that business enterprises should assume social responsibilities.

(v) Availability of resources with business: This argument holds that business institutions have valuable financial and human resources which can be effectively used for solving problems. For example, business has a pool of managerial talent and capital resources, supported by years of experience in organising business activities. It can help society to tackle its problems better, given the huge financial and human resources at its disposal.

(vi) Converting problems into opportunities: Related with the preceding argument is the argument that business with its glorious history of converting risky situations into profitable deals, can not only solve social problems but it can also make them effectively useful by accepting the challenge.

(vii) Better environment for doing business: If business is to operate in a society which is full of diverse and complicated problems, it may have little chance of success. Therefore, it is argued that the business system should do something to meet needs before it is confronted with a situation when its own survival is endangered due to enormous social illnesses. A society with fewer problems provides better environment for a firm to conduct its business.

(viii) Holding business responsible for social problems: It is argued that some of the social problems have either been created or perpetuated by business enterprises themselves. Environmental pollution, unsafe workplaces, corruption in public institutions, and discriminatory practices in employment are some of these problems. Therefore, it is the moral obligation of business to get involved in solving these problems, instead of merely expecting that other social agencies will deal with them on their own.

6.3.2 Arguments against Social Responsibility

Major arguments against social responsibility are:

(i) Violation of profit maximisation objective: According to this argument, business exists only for profit maximisation. Therefore, any talk of social responsibility is against this objective. In fact, business can best fulfill its social responsibility if it maximises profits through increased efficiency and reduced costs.

(ii) Burden on consumers: It is argued that social responsibilities like pollution control and environmental protection are very costly and often require huge financial investments. In such circumstances, businessmen are likely to simply shift this burden of social responsibility by charging higher prices from the consumers instead of bearing it themselves. Therefore, it is unfair to tax the consumers in the name of social responsibility.

(iii) Lack of social skills: All social problems cannot be solved the way business problems are solved. In fact, businessmen do not have the necessary understanding and training to solve social problems. Therefore, according to this argument, social problems should be solved by other specialised agencies.

(iv) Lack of broad public support: Here the argument is that the public in general does not like business involvement or interference in social programmes. Therefore, business cannot operate successfully because of lack of public confidence and cooperation in solving social problems.

6.3.3 Reality of Social Responsibility

On the basis of the above arguments for and against social responsibility, one may wonder what the businessmen do in reality. Do they concentrate on profit maximisation? Or, do they support social goals? The fact is that one of the most important recent changes in the attitude of business people has been the realisation that they have social obligations to fulfill besides ensuring their own existence through profitable activity. Of course, part of this realisation is not genuine and takes the form of lip service, which is thought necessary to ensure the survival of private enterprise. But at the same time it cannot be denied that private business does partly realise and recognise the hard reality that a privately owned firm has to meet the challenge of a democratic society, where all people have certain human rights and therefore, can demand responsible conduct from business. Unless the business sets its house in order, changes its outlook and is prepared to play its legitimate role as an organ of society, it has little chance of success. It will be useful here to go into some of the reasons and factors, which have forced and persuaded businessmen to consider their responsibilities and the conditions which were favourable to the development of business concern with social responsibility. Some of the more important among them are:

(i) Threat of public regulation: Democratically elected governments of today are expected to act as welfare states whereby they have to take care of all sections of society. Thus, where business institutions operate in a socially irresponsible manner, action is taken to regulate them for safeguarding people's interest. This threat of public regulation is one important reason due to which business enterprise feels concerned with social responsibility.

(ii) Pressure of labour movement: Over the last century or so, labour has become far more educated and organised. Accordingly, labour movement for extracting gains for the working class throughout the world has become very powerful. This has forced business enterprises to pay due regard to the welfare of workers instead of following a policy of 'hire and fire' under which they could deal with workers at their will.

(iii) Impact of consumer consciousness: Development of education and mass media and increasing competition in the market have made the consumer conscious of his right and power in determining market forces. The principle of *caveat emptor* (or let the buyer beware) has been substituted by the principle of 'customer is king'. Business enterprises have started following customer-oriented policies.

(iv) Development of social standard for business: Businesses are no longer considered merely money crazy entities, which can be allowed to mint money at any cost and get away with any kind of business practices. New social standards consider economic activity of business enterprises as legitimate but with the condition that they must also serve social needs. No business can be done in isolation from society. It is the society that permits business to exist and grow and it is on the basis of social standards that business functioning is to be ultimately judged.

(v) Development of business education: Development of business education with its rich content of social responsibility has made more and more people aware of the social purpose of business. Educated persons as consumers, investors, employees, or owners have become more sensitive towards social issues than was the case earlier, when such education was not available.

(vi) Relationship between social interest and business interest: Business enterprises have started realising the fact that social interest and business interest are not contradictory. Instead, these are complementary to each other. The feeling that business can grow only through exploitation of society has given way to the belief that long-term benefit of business lies in serving the society well. So also, a useful institution like business is recognised as an essential element of a modern civilised society.

(vii) Development of professional, managerial class: Professional management education in universities and specialised management institutes have created a separate class of professional managers who have got an altogether different attitude towards social responsibility as compared to the earlier class of owner manager. Professional managers are more interested in satisfying a multiplicity of interest groups in society for running their enterprises successfully than merely following profit goals.

These and a number of other social and economic forces have combined together to make business a socio-economic activity. Business is no longer a mere occupation; it is an economic institution that has to reconcile its short-term and long range economic interests with the demands of the society in which it functions. Essentially, it is this which gives rise to the general and specific social responsibilities of business. While there is no denial of the fact that business is essentially an economic enterprise and that it must ultimately justify itself on economic performance, it is also true that business is an organ of society and as such it must justify its continuance by fulfilling its roles and responsibilities of society.

6.4 Kinds Of Social Responsibility

Social responsibility of business can broadly be divided into four categories, which are as follows:

(a) **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.

(b) **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.

(c) **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.

(d) **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.

6.5 Social Responsibility Towards Different Interest Groups

Once the social objective of business is recognised, it is important to know to whom and for what the business and its management are responsible. Obviously, a business unit has to decide in which areas it should carry out social goals. Some of the specific responsibilities and enterprise may be outlined as under:

(i) Responsibility towards the shareholders or owners: A business enterprise has the responsibility to provide a fair return to the shareholders or owners on their capital investment and to ensure the safety of such investment. The corporate enterprise on a company form of organisation must also provide the shareholders with regular, accurate and full information about its working as well as schemes of future growth.

(ii) Responsibility towards the workers: Management of an enterprise is also responsible for providing opportunities to the workers for meaningful work. It should try to create the right kind of working conditions so that it can win the cooperation of workers. The enterprise must respect the democratic rights of the workers to form unions. The worker must also be ensured of a fair wage and a fair deal from the management.

(iii) Responsibility towards the consumers: Supply of right quality and quantity of goods and services to consumers at reasonable prices constitutes the responsibility of an enterprise toward its customers. The enterprise must take proper precaution against adulteration, poor quality, lack of desired service and courtesy to customers, misleading and dishonest advertising, and so on. They must also have the right of information about the product, the company and other matters having a bearing on their purchasing decision.

(iv) Responsibility towards the government and community: An enterprise must respect the laws of the country and pay taxes regularly and honestly. It must behave as a good citizen and act according to the well accepted values of the society. It must protect the natural environment and should avoid bad, effluent, smoky chimneys, ugly buildings dirty working conditions. It must also develop a proper image in society through continuous interaction with various groups of people.

6.6 Business and Environmental Protection

Protection of the environment is a serious issue that confronts business managers and decision makers. The environment is defined as the totality of man's surroundings — both natural and man-made. These surroundings are also in the nature of resources, that are useful for human life. The resources may also be called natural resources like land, water, air, fauna and flora and raw materials; or man-made resources such as cultural heritage, socio-economic institutions and the people. It is widely recognised that the quality of the environment is fast deteriorating particularly due to industrial activity. This is a common sight around major cities like Kanpur, Jaipur, Delhi, Panipat, Kolkata, and others, in various states of our country. Their emissions are seriously affecting the health of the people. Pollution — the injection of harmful substances into the environment is, in fact, largely the result of industrial production. Since some waste is inevitable in the use of materials and energy, the manufacturers face a great challenge in minimising the adverse impact of this waste by using proper technologies. Protection of the environment is good for all of us.

Pollution changes the physical, chemical and biological characteristics of air, land and water. Pollution harms human life and the life of other species. It also degrades living conditions while wasting or depleting raw material resources. The country's cultural heritage is also affected and it is becoming increasingly difficult to protect all historical monuments. Pollution exists because the environment can absorb only a limited amount of pollutants and wastes. Some hazardous wastes or toxic by-products and chemicals are termed as hazardous pollutants because they have toxic characteristics that the environment can not assimilate. Pollution thus causes risks to environmental quality, human health and damage to natural and man-made resources. Protection of the environment is directly related to the control of pollution.

6.6.1 Causes of Pollution

It must be recognised that all sectors of our society viz., industry, government, agriculture, mining, energy, transportation, construction, and consumers generate waste. Wastes contain pollutants which are the materials of chemicals that have been discarded during the process of production or consumption. Pollution is caused by these pollutants which are released into the environment beyond its assimilation capacity. Among the various sources of pollution, industry is a major generator of waste in terms of both its quantity and toxicity. Business activities such as production, distribution, transport, storage, consumption of goods and services are known to be the most critical sources of environmental pollution problems. Many business enterprises have been responsible for causing (i) air, (ii) water (iii) land, and (iv) noise pollution.

These types of pollution are discussed as follows:

(i) Air pollution: Air pollution is the result of a combination of factors which lowers the air quality. It is mainly due to carbon monoxide emitted by automobiles which contributes to air pollution. Similarly, smoke and other chemicals from manufacturing plants pollute the air. Resultant air pollution has created a hole in the ozone layer leading to dangerous warming of the earth.

(ii) Water pollution: Water becomes polluted primarily from chemical and waste dumping. For years, business

Environmental Problems

The United Nations has identified eight problems that cause damage to the natural environment. These are:

(i) Ozone depletion
(ii) Global warming
(iii) Solid and hazardous wastes
(iv) Water pollution
(v) Freshwater quality and quantity
(vi) Deforestation
(vii) Land degradation
(viii) Danger to biological diversity

enterprises have been dumping waste into rivers, streams and lakes with little regard for the consequences. Water pollution has led to the death of several animals and posed a serious threat to human life.

(iii) Land pollution: Dumping of toxic wastes on land causes land pollution. This damages the quality of land making it unfit for agriculture or plantation. Restoring the quality of the land that has already been damaged is a big problem.

(iv) Noise pollution: Noise caused by the running of factories and vehicles is not merely a source of annoyance but is also a serious health hazard. Noise pollution can be responsible for many diseases like loss of hearing, malfunctioning of the heart and mental disorder.

6.6.2 Need for Pollution Control

Pollution prevention or control is needed to preserve precious environmental resources and to improve the environmental quality so that the preserved resources can be utilised for the benefit of mankind and the improvement of health and well-being of the people. The amount of damage to a particular medium (air, water, land) varies according to the type of pollutant, the amount of pollutant disposed of, and the distance from the source of pollution. But all pollutants alter the quality of the environment and render it, to some degree, unfit to preserve normal life. People are now raising their voice loudly against pollution generating activities. Business enterprises cannot remain unaffected by environmental destruction. They need to take suitable measures for pollution control not merely to avoid criticisms against them but also to enjoy other benefits of such measures. Some of the important reasons which make a case for pollution control are as follows:

(i) Reduction of health hazards: There is increasing evidence that many diseases like cancer, heart attacks and lung complications are caused by pollutants in the environment. Pollution control measures can not only check the seriousness of such diseases but can also be supportive of a healthy life on earth.

(ii) Reduced risk of liability: It is possible that an enterprise is held liable to pay compensation to people affected by the toxicity of gaseous, liquid and solid wastes it has released into the environment. Therefore, it is sound business policy to install pollution control devices in its premises to reduce the risk of liability.

(iii) Cost savings: An effective pollution control programme is also needed to save costs of operating business. Cost savings are particularly noticeable when improper production technology results in greater wastes which leads to higher cost of waste disposal and cost of cleaning the plants.

(iv) Improved public image: As society becomes increasingly conscious of environmental quality, a firm's policies and practices for controlling wastes will increasingly influence people's attitude towards its working. A firm that promotes the cause for environment will be able to enjoy a good reputation and will be perceived as a socially responsible enterprise.

(v) Other social benefits: Pollution control results in many other benefits like clearer visibility, cleaner buildings, better quality of life, and the availability of natural products in a purer form.

6.6.3 Role of Business in Environmental Protection

Since the quality of the environment is important for all of us, we have a collective responsibility to protect it from being spoiled. Whether it is government, business enterprises, consumers, workers, or other members of society, each one can do something to stop polluting the environment. Government can enact laws to ban hazardous products. Consumers, workers and the members of society can avoid using certain products and doing things that are not environment friendly.

The business enterprises should, however, take the lead in providing their own solutions to environmental problems. It is the social responsibility of every business to take steps not only to check all sorts of pollution but also to protect environmental resources. Business enterprises are leading creators of wealth, employment, trade and technology. They also command huge financial, physical and human resources. They also have the know-how to solve environmental pollution problems with a preventive approach by controlling pollutants at the source. In most cases, a modification or change in the process of production, redesign of equipment, substituting poor quality materials with better ones or other innovative approaches could greatly reduce or even eliminate pollution entirely. Some of the specific steps which can be taken by business enterprises for environmental protection are as stated below:

(i) A definite commitment by top management of the enterprise to create, maintain and develop work culture for environmental protection and pollution prevention.

(ii) Ensuring that commitment to environmental protection is shared throughout the enterprise by all divisions and employees.

(iii) Developing clear-cut policies and programmes for purchasing good quality raw materials, employing superior technology, using scientific techniques of disposal and treatment of wastes and developing employee skills for the purpose of pollution control.

(iv) Complying with the laws and regulations enacted by the Government for prevention of pollution.

(v) Participation in government programmes relating to management of hazardous substances, clearing up of polluted rivers, plantation of trees, and checking deforestation.

(vi) Periodical assessment of pollution control programmes in terms of costs and benefits so as to increase the progress with respect to environmental protection.

(vii) Arranging educational workshops and training materials to share technical information and experience with suppliers, dealers and customers to get them actively involved in pollution control programmes.

6.7 Business Ethics

From the social point of view, business exists to supply goods and services to the people. From the individual point of view, the primary objective of a business firm is to earn profit. One may expect that the individual goals of the firm would not be in conflict with the objectives of society. However, business enterprises are run by human beings whose decisions and actions may not always be in accordance with the expectations of society. An enterprise may be good in terms of economic performance (like revenue, costs and profits) but poor in terms of social performance like supplying products of reasonable quality and at reasonable prices. This raises the question of what is right or wrong from society's point of view. The answer to this question is important because business enterprises are products of and are influenced by society. They have to interpret and adjust to the preferences or values of society. The subject matter of ethics is concerned with establishing linkages between individual good and social good.

Environmental Protection in India
(Steps by the Government)

1. Laws: The directive principles of state policy in the Constitution of India lay emphasis on protection of environment. Some of the laws enacted are as under:
   i. The Wildlife Protection Act, 1972
   ii. The Water (Prevention and Control of Pollution) Act, 1974 amended in 1974 and 1988
   iii. The Air (Prevention and Control of Pollution) Act, 1974 amended in 1974 and 1988
   iv. The Environment (Protection) Act, 1986
   v. The Forests (Conservation Act, 1980 amended in 1988
   vi. The Hazardous Wastes Act, 1989
2. Regulations: Administrative orders/policy guidelines have been laid down by the government. A separate Department of Environment, Government of India was created in 1980.
3. Certain regulatory bodies or quasi-judicial authorities have been established such as:
   - National Afforestation and Eco-development Board, and
   - National Wastelands Development Board
4. Manufacturing units have been closed in cities. High Court of Delhi ordered shifting of manufacturing units out of Delhi and closing them. Similarly, courts have ordered removal of foundaries from Agra city, and shifting of manufacturing factories from Kanpur.
5. Various programmes on environment education, and seminars on creating awareness and resource are being organised regularly.
6. Government has also laid down Environment Action Plan (EAP).

6.7.1 Concept of Business Ethics

The word 'ethics' has its origin in the Greek word 'ethics' meaning character; norms, ideals or morals prevailing in a group or society. Ethics is concerned with what is right and what is wrong in human behaviour judged on the basis of a standard form of conduct/ehaviour of individuals, as approved by society in a particular field of activity. Ethics may be viewed as the entire body of moral values that society attaches to the actions of human beings. Ethics can also refer to codes or other system for controlling means so that they serve human ends. Ethical standards are often enacted into laws. But ethical behaviour is just and fair conduct which goes beyond observing laws and government regulations. It means adhering to moral principles, being guided by particular values, and behaving in a way people ought to act. The set of principles called ethics may be written or unwritten codes or principles governing a professional or human activity.

Business ethics concerns itself with the relationship between business objectives, practices, and techniques and the good of society. Business ethics refer to the socially determined moral principles which should govern business activities. A few examples of business ethics are: charging fair prices from customers, using fair weights for measurement of commodities, giving fair treatment to workers and earning reasonable profits. A businessperson behaves ethically when her or his actions are upright and serve the interests of society. This, of course, also applies to those not in business. The essential difference is perhaps that businesspersons by virtue of their widespread control over society's resources have a much greater effect on what happens in a society than persons in other areas of activity do. Business people and politicians are expected to have higher standards over and above other people. This is perhaps the price they pay for being allowed to make decisions on behalf of society.

There is a growing realisation all over the world that ethics is vitally important for every business and for the progress of any society. Ethical business is good business. Ethical business behaviour improves public image, earns people's confidence and trust, and leads to greater success. Ethics and profits go together in the long run. Ethics alone, and not government or laws, can make a society great. An ethically responsible enterprise develops a culture of caring for people and environment and commands a high degree of integrity in dealing with others. Ethical activity is indeed valuable in itself, for its own sake, because it enhances the quality of our lives and that of the work we do.

6.7.2 Elements of Business Ethics

Since ethical business behaviour is good for both the business enterprise and society, it makes sense to discuss how the enterprises can foster ethics in their day-to-day working. Some of the basic elements of business ethics while running a business enterprise are as follows:

(i) Top management commitment: Top management has a crucial role in guiding the entire organisation towards ethically upright behaviour. To achieve results, the Chief Executive Officer (CEO) and other higher level managers need to be openly and strongly committed to ethical conduct. They must give continuous leadership for developing and upholding the values of the organisation.

(ii) Publication of a 'Code': Enterprises with effective ethics programmes do define the principles of conduct for the whole organisation in the form of written documents which is referred to as the "code". This generally covers areas such as fundamental honesty and adherence to laws; product safety and quality; health and safety in the workplace; conflicts of interest; employment practices; fairness in selling/marketing practices; and financial reporting.

(iii) Establishment of compliance mechanisms: In order to ensure that actual decisions and actions comply with the firm's ethical standards, suitable mechanisms should be established. Some examples of such mechanisms are: paying attention to values and ethics in recruiting and hiring; emphasising corporate ethics in training; auditing performance regularly to analyse the degree of compliance; and instituting communication systems to help employees report incidents of unethical behaviour.

(iv) 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 groups of employees can be formed to discuss the important ethics policies of firms and examine attitudes of employees towards these policies.

(v) Measuring results: 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.

Ground Rules of Ethics

The following are some of the universal virtues which every human being should imbibe, develop and practise to be ethical in life:

(a) Be trustworthy
(b) Have respect for others
(c) Own responsibility
(d) Be fair in dealings
(e) Be caring towards the well-being of others
(f) Prove to be a good citizen — through civil virtues and duties

Key Terms

Social responsibility	Water pollution	Business ethics
Environment	Noise pollution	Legal responsibility
Environmental protection	Air pollution	Ethics
Pollution	Land pollution	Code of ethics

SUMMARY

Concept of social responsibility: Social responsibility of business refers to its obligation to take those decisions and perform those actions which are desirable in terms of the objectives and values of our society.

Need for social responsibility: Need for social responsibility of business arises both because of firm's interest and the interest of society. However, there are arguments both for and against social responsibility.

Arguments for social responsibility: Major arguments are: (i) justification for existence and growth, (ii) long-term interest and image of the firm, (iii) avoidance of government regulation, (iv) maintenance of orderly society, (v) availability of resources with business, (vi) converting problems into opportunity, (vii) better environment for doing business, and (viii) holding the business responsible for social problems.

Arguments against social responsibility: Major arguments against social responsibility are: (i) violation of profit maximisation objective, (ii) burden on consumers, (iii) lack of social skills and (iv) lack of broad public support.

Reality of social responsibility: Reality of social responsibility is that, despite differing arguments relating to social responsibility, business enterprises are concerned with social responsibility because of the influence of certain external forces. These forces are: (i) threat of public regulation, (ii) pressure of labour movement, (iii) impact of consumer consciousness, (vi) development of social standard for businessmen, (v) development of business education, (vi) relationship between social interest and business interest, and (vii) development of professional, managerial class.

Social responsibility towards different interest groups: Business enterprises have responsibility towards (i) shareholders or owners, (ii) workers, (iii) consumers and (iv) government and community giving fair return on and safety of investment to shareholders, providing opportunities to workers for meaningful work, supplying right quality and quantity of goods and services to consumers and paying to the government, and protecting natural environment are some of the social responsibilities of business.

Business and environment protection: Protection of the environment is a serious issue that confronts managers and decision makers. The environment is defined as the totality of man's surroundings — both natural and man-made. Pollution — the injection of harmful substances into the environment is, in fact, largely the result of industrial production. Pollution has harmful effects both for human life and the life of other species.

Causes of Pollution: Among the various sources of pollutions, industry is a major generator of waste in terms of both its quantity and toxicity. Many business enterprises have been responsible for causing air, water, land and noise pollution.

Need for pollution control: Important reasons which make a case for pollution control are: (i) reduction of health hazards, (ii) reduced risk of liability, (iii) cost savings (iv) improved public image, and (v) other social benefits.

Role of business in environmental protection: Each member of society can do something to protect the environment. The business enterprises should, however, take the lead in providing their own solutions to environmental problems. Some of the steps that they can take are: top management commitment, clear-out policies and programmes, abiding by government regulations, participation in government programmes, periodical assessment of pollution control programmes, and proper education and training of concerned people.

Concept of business ethics: Ethics is concerned with what is right and what is wrong in human behaviour judged on the basis of socially determined standards of behaviour. Business ethics concerns itself with relationship between objectives, practices, and techniques and the good of society. Ethics is important for every business.

Elements of business ethics: An enterprise can foster ethics at the workplace by following basic elements of business ethics, such as (i) top management's commitment, (ii) publication of a establishment of compliance mechanism, (iv) involving employees at all levels and (v) measuring results.

EXERCISES

Multiple Choice Questions

1. Social responsibility is

   a. Same as legal responsibility

   b. Broader than legal responsibility

   c. Narrower than legal responsibility

   d. None of them

2. If business is to operate in a society which is full of diverse and complicated problems, it may have

   a. Little chance of success
   b. Great chance of success
   c. Little chance of failure
   d. No relation with success or failure.

3. Business people have the skills to solve

   a. All social problems
   b. Some social problems
   b. No social problems
   d. All economic problems

4. That an enterprise must behave as a good citizen is an example of its responsibility towards

   a. Owners
   b. Workers
   c. Consumers
   d. Community

5. Environmental protection can best be done by the efforts of

   a. Business people
   b. Government
   c. Scientists
   d. All the people

6. Carbon monoxide emitted by automobiles directly contributes to

   a. Water pollution
   b. Noise pollution
   c. Land pollution
   d. All the people

7. Which of the following can explain the need for pollution control?

   a. Cost savings
   b. Reduced risk of liability
   c. Reduction of health hazards
   d. All of them

8. Which of the following is capable of doing maximum good to society?

   a. Business success
   b. Laws and regulations
   c. Ethics
   d. Professional management

9. Ethics is important for

   a. Top management
   b. Middle-level managers
   c. Non-managerial employees
   d. All of them

10. Which of the following alone can ensure effective ethics programme in a business enterprise?

    a. Publication of a code
    b. Involvement of employees
    c. Establishment of compliance mechanisms
    d. None of them

Short Answer Questions

1. What do you understand by social responsibility of business? How is it different from legal responsibility?

2. What is environment? What is environmental pollution?
3. What is business ethics? Mention the basic elements of business ethics.
4. Briefly explain (a) Air Pollution, (b) Water pollution, and (c) Land pollution.
5. What are the major areas of social responsibility of business?
6. State the meaning of Corporate Social Responsibility as per the Companies Act 2013.

Long Answer Questions

1. Build up arguments for and against social responsibilities.
2. Discuss the forces which are responsible for increasing concern of business enterprises toward social responsibility.
3. 'Business is essentially a social institution and not merely a profit making activity'. Explain.
4. Why do the enterprises need to adopt pollution control measures?
5. What steps can an enterprise take to protect the environment from the dangers of pollution?
6. Explain the various elements of business ethics.
7. Discuss the guidelines enumerated by the Companies Act 2013 for Corporate Social Responsibility.

Projects/Assignments

1. Develop and put in writing a code of ethics for use in the classroom. Your document should include guidelines for students, teachers, and the principal.
2. Using newspapers, magazines and other business references, identify and describe at least three companies that you think are socially responsible and three that you think are socially irresponsible.
3. Choose a company and prepare a report on Corporate Social Responsibility undertaken by it.

(Hint : *Swachh Bharat Abhiyan*, Budding Artists Fund, start-ups, Education, Skill India, women and other marginalised groups.)

Part-II

Corporate Organisation, Finance and Trade

CHAPTER 7

FORMATION OF A COMPANY

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- specify the important stages in the formation of a company;
- describe the steps involved in each stage of company formation;
- specify the documents to be submitted to the registrar of companies; and
- state the need of certificate of incorporation and certificate to commence business.

Avtar, a brilliant automobile engineer, has recently developed a new carburettor in his factory which he is running as a sole proprietor. The new carburettor can cut down petrol consumption of a car engine by 40 percent. He is now thinking of producing it on a large scale for which he requires a large amount of money. He is to evaluate different forms of organisations for doing the business of manufacturing and marketing his carburettor. He decides against converting his sole proprietorship to partnership as the requirement of funds for the project is large and the product being new, there is a lot of risk involved. He is advised to form a company. He wants to know about the formalities required for the formation of a company.

7.1 Introduction

Modern day business requires large amount of money. Also, due to increasing competition and fast changing technological environment, the element of risk is increasing. As a result, the company form of organisation is being preferred by more and more business firms, particularly for setting up medium and large sized organisations.

The steps which are required from the time a business idea originates to the time, a company is legally ready to commence business are referred to as stages in the formation of a company. Those who are taking these steps and the associated risks are promoting a company and are called its promoters.

The present chapter describes in some details the stages in the formation of a company and also the steps required to be taken in each stage so that a fair idea about these aspects can be made.

7.2 Formation of a Company

Formation of a company is a complex activity involving completion of legal formalities and procedures. To fully understand the process one can divide the formalities into three distinct stages, which are: (i) Promotion; (ii) Incorporation and (iii) Subscription of capital.

It may, however, be noted that these stages are appropriate from the point of view of formation of any kind of company. Private company as against the public limited company is prohibited to raise funds from public, it does not need to issue a prospectus and complete the formality of minimum subscription.

In the next section, we shall discuss the stages in the formation of a company in detail.

7.2.1 Promotion of a Company

Promotion is the first stage in the formation of a company. It involves conceiving a business idea and taking an initiative to form a company so that practical shape can be given to exploiting the available business opportunity. Thus, it begins with somebody having discovered a potential business idea. Any person or a group of persons or even a company may have discovered an opportunity. If such a person or a group of persons or a company proceeds to form a company, then, they are said to be the promoters of the company.

A promoter is said to be the one who undertakes to form a company with reference to a given project and to set it going and who takes the necessary steps to accomplish that purpose. Thus, apart from conceiving a business opportunity the promoters analyse its prospects and bring together the men, materials, machinery, managerial abilities and financial resources and set the organisation going.

As per section 69, a promoter means a person

(a) Who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or
(b) Who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
(c) In accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act. However, it is provided that nothing in this sub-clause shall apply to a person who is acting merely in a professional capacity.

After thoroughly examining the feasibility of the idea, the promoters assemble resources, prepare necessary documents, give a name and perform various other activities to get a company registered and obtain the necessary certificate enabling the company to commence business. Thus, the promoters perform various functions to bring a company into existence.

Functions of a Promoter

The important functions of promoters may be listed as below:

(i) Identification of business opportunity: The first and foremost activity of a promoter is to identify a business opportunity. The opportunity may be in respect of producing a new product or service or making some product available through a different channel or any other opportunity having an investment potential. Such opportunity is then analysed to see its technical and economic feasibility.

(ii) Feasibility studies: It may not be feasible or profitable to convert all identified business opportunities into real projects. The promoters, therefore, undertake detailed feasibility studies to investigate all aspects of the business they intend to start. Depending upon the nature of the project, the following feasibility studies may be undertaken, with the help of the specialists like engineers, chartered accountants etc., to examine whether the perceived business opportunity can be profitably exploited.

(a) **Technical feasibility:** Sometimes an idea may be good but technically not possible to execute.

It may be so because the required raw material or technology is not easily available. For example, in our earlier story suppose Avtar needs a particular metal to produce the carburettor. If that metal is not produced in the country and because of poor political relations, it can not be imported from the country which produces it, the project would be technically unfeasible until arrangements are made to make the metal available from alternative sources.

(b) **Financial feasibility:** Every business activity requires funds. The promoters have to estimate the fund requirements for the identified business opportunity. If the required outlay for the project is so large that it cannot easily be arranged within the available means, the project has to be given up. For example, one may think that developing townships is very lucrative. It may turn out that the required funds are in several crores of rupees, which cannot be arranged by floating a company by the promoters. The idea may be abandoned because of the lack of financial feasibility of the project.

(c) **Economic feasibility:** Sometimes it so happens that a project is technically viable and financially feasible but the chance of it being profitable is very little. In such cases as well, the idea may have to be abondoned. Promoters usually take the help of experts to conduct these studies. It may be noted that these experts do not become promoters just because they are assisting the promoters in these studies.

Only when these investigations throw up positive results, the promoters may decide to actually launch a company.

Name Clause

A name is considered undesirable in the following cases:

(a) If it is identical with or too closely resembles the name of an existing company

(b) If it is misleading. It is so considered if the name suggests that the company is in a particular business or it is an association of a particular type when it is not true

(c) If it is violative of the provisions of 'The Emblem and Names (Prevention of Improper Use) Act 1950, as given in the schedule to this Act. This schedule specifies, inter alia, the name, emblem or official seal of the UNO and its bodies like WHO, UNESCO etc. Government of India, State Governments, President of India or Governer of any State, the Indian National Flag. The Act also prohibits use of any name which may suggest patronage of Government of India, or any state government or any local authority

(iii) Name approval: Having decided incorporate to a company, the promoters have to select a name for it and submit, an application to the registrar of companies of the state in which the registered office of the company is to be situated, for its approval. The proposed name may be approved if it is not considered undesirable. It may happen that another company exists with the same name or a very similar name or the preferred name is misleading, say, to suggest that the company is in a particular business when it is not true. In such cases the proposed name is not accepted but some alternate name may be approved. Therefore, three names, in order of their priority are given in the application to the Registrar of Companies. (Performa INC1 is given at the end of the Book).

(iv) Fixing up Signatories to the Memorandum of Association: Promoters have to decide about the members who will be signing the Memorandum of Association of the proposed company. Usually the people signing memorandum are also the first Directors of the Company. Their written consent to act as Directors and to take up the qualification shares in the company is necessary.

(v) Appointment of professionals: Certain professionals such as mercantile bankers, auditors etc., are appointed by the promoters to assist them in the preparation of necessary documents which are required to be with the Registrar of Companies. The names and addresses of shareholders and the number of shares allotted to each is submitted to the Registrar in a statement called return of allotment.

(vi) Preparation of necessary documents: The promoter takes up steps to prepare certain legal documents, which have to be submitted under the law, to the Registrar of the Companies for getting the company registered. These documents are Memorandum of Association, Articles of Association and Consent of Directors.

Documents Required to be Submitted

A. Memorandum of Association: Memorandum of Association is the most important document as it defines the objectives of the company. No company can legally undertake activities that are not contained in its Memorandum of Association. As per section 2(56) of The Companies Act, 2013 "memorandum" means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act. The Memorandum of Association contains different clauses, which are given as follows:

(i) The name clause: This clause contains the name of the company with which the company will be known, which has already been approved by the Registrar of Companies.

(ii) Registered office clause: This clause contains the name of the state, in which the registered office of the company is proposed to be situated. The exact address of the registered office is not required at this stage but the same must be notified to the Registrar within thirty days of the incorporation of the company.

(iii) Objects clause: This is probably the most important clause of the memorandum. It defines the purpose for which the company is formed. A company is not legally entitled to undertake an activity, which is beyond the objects stated in this clause. The main objects for which the company is formed are listed in this sub-clause. It must be observed that an act which is either essential or incidental for the attainment of the main objects of the company is deemed to be valid, although it may not have been stated explicitly.

Respective forms for Memorandum of Association

1.	Table A	MOA of a company limited by shares
2.	Table B	MOA of a company limited by guarantee and not having share capital
3.	Table C	MOA of a company limited by guarantee and not having share capital
4.	Table D	MOA of an unlimited company and not having share capital
5.	Table E	MOA of an unlimited company and having share capital
Respective forms for Articles of a Company		
6.	Table F	AOA of a company limited by shares
7.	Table G	AOA of a company limited by guarantee and having share capital
8.	Table H	AOA of a company limited by guarantee and not having share capital
9.	Table I	AOA of an unlimited company and having share capital
10.	Table J	AOA of an unlimited company and not having share capital

(iv) Liability clause: This clause limits the liability of the members to the amount unpaid on the shares owned by them.

For example, if a shareholder has purchased 1000 shares of Rs.10 each and has already paid Rs. 6 per share, his/her liability is limited to Rs. 4 per share. Thus, even in the worst case, he/she may be called upon to pay Rs. 4, 000 only.

(v) Capital clause: This clause specifies the maximum capital which the company will be authorised to raise through the issue of shares. The authorised share capital of the proposed company along with its division into the number of shares having a fixed face value is specified in this clause. For example, the authorised share capital of the company may be Rs. 25 lakhs with divided into 2.5 lakh shares of Rs.10 each. The said company cannot issue share capital in excess of the amount mentioned in this clause.

The signatories to the Memorandum of Association state their intention to be associated with the company and give their undertaking to subscribe to the shares mentioned against their names. The memorandum of a company shall be in respective forms specified in Tables A, B, C, D and E in Schedule I as may be applicable to such company.

The Memorandum of Association must be signed by at least seven persons in case of a public company and by two persons in case of a private company.

A copy of a Memorandum of Association is given at the end of the chapter.

B. Articles of Association: Articles of Association are the rules regarding internal management of a company. These rules are subsidiary to the Memorandum of Association and hence, should not contradict or exceed anything stated in the Memorandum of Association.

According to section 2(5) of The Companies Act, 2013, 'articles' means the article of association of a company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act. The articles of a company shall be in respective forms as specified in Table F, G, H, I and J in schedule I as may be applicable to such company. However, the companies are free to make their own articles of association which may be contrary to the clauses of Table F,G,H,I,J and in that case articles of association as adopted by the company shall apply.

C. Consent of Proposed Directors: Apart from the Memorandum and Articles of Association, a written consent of each person named as a director is required confirming that they agree to act in that capacity and undertake to buy and pay for qualification shares, as mentioned in the Articles of Association.

D. Agreement: The agreement, if any, which the company proposes to enter with any individual for appointment as its Managing

Qualification Shares

To ensure that the directors have some stake in the proposed company, the Articles usually have a provision requiring them to buy a certain number of shares. They have to pay for these shares before the company obtains Certificate of Commencement of Business. These are called Qualification Shares.

The Articles generally contains the following matters:

1. Exclusion wholly or in part of Table F.
2. Adoption of preliminary contracts.
3. Number and value of shares.
4. Issue of preference shares.
5. Allotment of shares.
6. Calls on shares.
7. Lien on shares.
8. Transfer and transmission of shares.
9. Nomination.
10. Forfeiture of shares.
11. Alteration of capital.
12. Buy back.
13. Share certificates.
14. Dematerialization.
15. Conversion of shares into stock. Incorporation of Companies and Matters Incidental Thereto
16. Voting rights and proxies.
17. Meetings and rules regarding committees.
18. Directors, their appointment and delegations of powers.
19. Nominee directors.
20. Issue of Debentures and stocks.
21. Audit committee.
22. Managing director, Whole-time director, Manager, Secretary.
23. Additional directors.
24. Seal.
25. Remuneration of directors.
26. General meetings.
27. Directors meetings.
28. Borrowing powers.
29. Dividends and reserves.
30. Accounts and audit.
31. Winding up.
32. Indemnity.
33. Capitalisation of reserves.

Director or a whole time Director or Manager is another document which is required to be submitted to the Registrar for getting the company registered under the Act.

E. **Statutory Declaration:** A declaration stating that all the legal requirements pertaining to registration have been complied with is to be submitted to the Registrar with the above mentioned documents for getting the company registered under the law. This statement can be signed by an advocate or by a Chartered Accountant or a Cost Accountant or a Company Secretary in practice who is engaged in the formation of a company and by a person named in the articles as a director or manager or secretary of the company.

F. **Receipt of Payment of fee:** Along with the above-mentioned documents, necessary fees has to be paid for the registration of the company. The amount of such fees shall depend on the authorised share capital of the company.

Position of Promoters

Promoters undertake various activities to get a company registered and get it to the position of commencement of business. But they are neither the agents nor the trustees of the company. They can't be the agents as the company is yet to be incorporated. Therefore, they are personally liable for all the contracts which are entered by them, for the company before its incorporation, in case the same are not ratified by the company later on. Also promoters are not the trustees of the company.

Promoters of a company enjoy a fiduciary position with the company, which they must not misuse. They can make a profit only if it is disclosed but must not make any secret profits. In the event of a non-disclosure, the company can rescind the contract and recover the purchase price paid to the promoters. It can also claim damages for the loss suffered due to the non-disclosure of material information.

Promoters are not legally entitled to claim the expenses incurred in the promotion of the company. However, the company may choose to reimburse them for the pre-incorporation expenses. The company may also remunerate the promoters for their efforts by paying a lump sum amount or a commission on the purchase price of property purchased through them or on the shares sold. The company may also allot them shares or debentures or give them an option to purchase the securities at a future date.

7.2.2 Incorporation

After completing the aforesaid formalities, promoters make an application for the incorporation of the company. The application is to be filed with the Registrar of Companies of the state within which they plan to establish the registered office of the company. The application for registration must be accompanied with certain documents about which we have already discussed in the previous sections. These may be briefly mentioned again:

1. The Memorandum of Association duly stamped, signed and witnessed. In case of a public company, at least seven members must sign it. For a private company however the signatures of two members are sufficient. The signatories must also give information about their address, occupation and the number of shares subscribed by them.
2. The Articles of Association duly stamped and witnessed as in case of the Memorandum. However, as stated earlier, a public company may adopt Table A, which is a model set of Articles, given in the Companies Act. In that case a statement in lieu of the prospectus is submitted, instead of Articles of Association.
3. Written consent of the proposed directors to act as directors and an undertaking to purchase qualification shares.
4. The agreement, if any, with the proposed Managing Director, Manager or whole-time director.
5. A copy of the Registrar's letter approving the name of the company.
6. A statutory declaration affirming that all legal requirements for registration have been complied with. This must be duly signed.
7. A notice about the exact address of the registered office may also be submitted along with these documents. However, if the same is not submitted at the time of incorporation, it can be submitted within 30 days of the receipt of the certificate of incorporation.
8. Documentary evidence of payment of registration fees.

The Registrar upon submission of the application along with the required documents has to be satisfied that the documents are in order and that all the

Preliminary Contracts

During the promotion of the company, promoters enter into certain contracts with third parties on behalf of the company. These are called preliminary contracts or pre-incorporation contracts. These are not legally binding on the company. A company after coming into existence may, if it so chooses, decide to enter into fresh contracts with the same terms and conditions to honour the contracts made by the promoters. Note that it cannot ratify a preliminary contract. A company thus cannot be forced to honour a preliminary contract. Promoters, however, remain personally liable to third parties for these contracts.

statutory requirements regarding the registration have been complied with. However, it is not his duty to carry out a thorough investigation about the authenticity of the facts mentioned in the documents.

When the Registrar is satisfied, about the completion of formalities for registration, a Certificate of Incorporation is issued to the company, which signify the birth of the company. The certificate of incorporation may therefore be called the birth certificate of the company.

With effect from November 1, 2000, the Registrar of Companies allots a CIN (Corporate Identity Number) to the Company.

Effect of the Certificate of Incorporation

A company is legally born on the date printed on the Certificate of Incorporation. It becomes a legal entity with perpetual succession on such date. It becomes entitled to enter into valid contracts. The Certificate of Incorporation is a conclusive evidence of the regularity of the incorporation of a company. Imagine, what would happen to an unsuspecting party with which the company enters into a contract, if it is later found that the incorporation of the company was improper and hence invalid. Therefore, the legal situation is that once a Certificate of Incorporation has been issued, the company has become a legal business entity irrespective of any flaw in its registration. The Certificate of Incorporation is thus conclusive evidence of the legal existence of the company. Some interesting examples showing the impact of the conclusiveness of the Certificate of Incorporation are as under:

(a) Documents for registration were filed on 6th January. Certificate of Incorporation was issued on 8th January. But the date mentioned on the Certificate was 6th January. It was decided that the company was in existence and the contracts signed on 6th January were considered valid.

(b) A person forged the signatures of others on the Memorandum. The Incorporation was still considered valid.

Director Identification Number (DIN)

Every Individual intending to be appointed as director of a company shall make an application for allotment of Director Identification Number (DIN) to the Central Government in prescribed form along with fees.

The Central Government shall allot a Director Identification Number to an application within one month from the receipt of the application.

No individual, who has already been allotted a Director Identification Number, shall apply for, obtain or possess another Director Identification Number

Thus, whatever be the deficiency in the formalities, the Certificate of Incorporation once issued, is a conclusive evidence of the existence of the company. Even when a company gets registered with illegal objects, the birth of the company cannot be questioned. The only remedy available is to wind it up. Because the Certificate of Incorporation is so crucial, the Registrar has to go very carefully before issuing it.

On the issue of Certificate of Incorporation, a private company can immediately commence its business. It can raise necessary funds from friends, relatives or through private arrangement and proceed to start business.

7.2.3 Capital Subscription

A public company can raise the required funds from the public by means of issue of securities (shares and debentures etc.). For doing the same, it has to issue a prospectus which is an invitation to the public to subscribe to the capital of the company and undergo various other formalities. The following steps are required for raising funds from the public:

(i) SEBI Approval: SEBI (Securities and Exchange Board of India) which is the regulatory authority in our country has issued guidelines for the disclosure of information and investor protection. A public company inviting funds from the general public must make adequate disclosure of all relevant information and must not conceal any material information from the potential investors. This is necessary for protecting the interest of the investors. Prior approval from SEBI is, therefore, required before going ahead with raising funds from public.

(ii) Filing of Prospectus: A copy of the prospectus or statement in lieu of prospectus is filed with the Registrar of Companies. A prospectus is 'any document described or issued as a prospectus including any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any securities of, a body corporate'. In other words, it is an invitation to the public to apply for securities (shares, debentures etc.) of the company or to make deposits in the company. Investors make up their minds about investment in a company primarily on the basis of the information contained in this document. Therefore, there must not be a mis-statement in the prospectus and all material significant information must be fully disclosed.

(iii) Appointment of Bankers, Brokers, Underwriters: Raising funds from the public is a stupendous task. The application money is to be received by the bankers of the company. The brokers try to sell the shares by distributing the forms and encouraging the public to apply for the shares. If the company is not

Difference between Memorandum of Association and Articles of Association

Basis of Difference	Memorandum of Association	Articles of Association
Objectives	Memorandum of Association defines the objects for which the company is formed.	Articles of Association are rules of internal management of the company. They indicate how the objectives of the company are to be achieved.
Position	This is the main document of the company and is subordinate to the Companies Act.	This is a subsidiary document and is subordinate to both the Memorandum of Association and the Companies Act.
Relationship	Memorandum of Association defines the relationship of the company with outsiders.	Articles define the relationship of the members and the company.
Validity	Acts beyond the Memorandum of Association are invalid and cannot be ratified even by a unanimous vote of the members.	Acts which are beyond Articles can be ratified by the members, provided they do not violate the Memorandum.
Necessity	Every company has to file a Memorandum of Association.	It is not compulsory for a public ltd. company to file Articles of Association. It may adopt Table F of The Companies Act, 2013

reasonably assured of a good public response to the issue, it may appoint underwriters to the issue. Underwriters undertake to buy the shares if these are not subscribed by the public. They receive a commission for underwriting the issue. Appointment of underwriters is not necessary.

(iv) Minimum Subscription: In order to prevent companies from commencing business with inadequate resources, it has been provided that the company must receive applications for a certain minimum number of shares before going ahead with the allotment of shares. According to the Companies Act, this is called the 'minimum subscription'. As per the SEBI Guidelines the limit of minimum subscription is 90 per cent of the size of the issue. Thus, if applications received for the shares are for an amount less than 90 per cent of the issue size, the allotment cannot be made and the application money received must be returned to the applicants.

(v) Application to Stock Exchange: An application is made to at least one stock exchange for permission to deal in its shares or debentures. If such permission is not granted before the expiry of ten weeks from the date of closure of subscription list, the allotment shall become void and all money received from the applicants will have to be returned to them within eight days.

(vi) Allotment of Shares: Till the time shares are alloted, application money received shoud remain in a seperate bank account and must not be used by the company. In case the number of shares allotted is less than the number applied for, or where no shares are allotted to the applicant, the excess application money, if any, is to be returned to applicants or adjusted towards allotment money due from them. Allotment letters are issued to the successful allottees. 'Return of allotment', signed by a director or secretary is filed with the Registrar of Companies within 30 days of allotment.

A public company may not invite public to subscribe to its securities (shares, debentures etc.). Instead, it can raise the funds through friends, relatives or some private arrangements as done by a private company. In such cases, there is no need to issue a prospectus. A 'Statement in Lieu of Prospectus' is filed with the Registrar at least three days before making the allotment.

One Person Company

With the implementation of The Companies Act, 2013, a single person could constitute a company, under the One Person Company (OPC) concept.

The introduction of OPC in the legal system is a move that would encourage corporatisation of micro businesses and entrepreneurship.

In India, in the year 2005, the JJ Irani Expert Committee recommended the formation of OPC. It had suggested that such an entity may be provided with a simpler legal regime through exemptions so that the small entrepreneur is not compelled to devote considerable time, energy and resources on complex legal compliance.

One Person Company is a company with only one person as a member. That one person will be the shareholder of the company. It avails all the benefits of a private limited company such as separate legal entity, protecting personal assets from business liability and perpetual succession.

Characteristics

(1) Only a natural person who is an Indian citizen and resident in India-
  (a) Shall be eligible to incorporate a One Person Company;
  (b) Shall be a nominee for the sole member of a One Person Company.
  Explanation – For the purposes of this rule, the term "resident in India" means a person who has stayed in India for a period of not less than one hundred and eighty two days during the immediately preceding one calendar year.

(2) No person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company.

(3) Where a natural person, being member in One Person Company in accordance with this rule becomes a member in another such Company by virtue of his being a nominee in that One Person Company, such person shall meet the eligibility criteria specified in sub rule (2) within a period of one hundred and eighty days.

(4) No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest.

(5) Such Company cannot be incorporated or converted into a company under section 8 of the Act.

(6) Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of anybody corporates.

(7) No such company can convert voluntarily into any kind of company unless two years have expired from the date of incorporation of One Person Company, except threshold limit (paid up share capital) is increased beyond fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees.

"SCHEDULE I"

(See sections 4 and 5)

Table A

MEMORANDUM OF ASSOCIATION OF A COMPANY LIMITED BY SHARES

1st The name of the company is ".. Limited/Private Limited".

2nd The registered office of the company will be situated in the State of ....

3rd (a) The objects to be pursued by the company on its incorporation are:-

....

....

(b) Matters which are necessary for furtherance of the objects specified in clause 3 (a) are:-

....

....

4th The liability of the member(s) is limited and this liability is limited to the amount unpaid, if any, on the shares held by them.

5th The share capital of the company is .... rupees, divided into .... shares of .... rupees each.

6th We, the several persons, whose names and addresses are subscribed, are desirous of beingformed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set against our respective names:-

Names, addresses, descriptions and occupations of subscribers	No. of shares taken by each	Signature of subscriber	Signature, names addresses, descriptions and occupations of witnesses
A.B. of .... Merchant	....		Signed before me: Signature ....
C.D. of .... Merchant	....		Signed before me: Signature ....
E.F. of .... Merchant	....		Signed before me: Signature ....

G.H. of .... Merchant	....		Signed before me: Signature ....
I.J. of .... Merchant	....		Signed before me: Signature ....
K.L. of .... Merchant	....		Signed before me: Signature ....
M.N. of .... Merchant	....		Signed before me: Signature ....
Total shares taken:			

7th I, whose name and address is given below, am desirous of forming a company in pursuance of this memorandum of association and agree to take all the shares in the capital of the company (Applicable in case of one person company):-

Names, addresses, occupations of Subscribers	Signature of subscribed	Signature, name, address, description and occupation of witness

8th Shri/Smt ...., son/daughter of ...., resident of .... aged .... years shall be the nominee in the event of death of the sole member (Applicable in case of one person company)

Dated .... The day of ....

Key Terms

Promotion	Memorandum of Association	Articles of Association
Prospectus	Incorporation	Capital subscription
Commencement of Business		

SUMMARY

There are two stages in the formation of a private company, promotion and incorporation. A public company has to undergo capital subscription stage to begin operations.

1. **Promotion:** It begins with a potential business idea. Certain feasibility studies e.g., technical, financial and economic, are conducted to determine whether the idea can be profitably exploited. In case, the investigations yield favourable results, promoters may decide to form the company. Persons who conceive the business idea, decide to form a company, take necessary steps for the same, and assume associated risks, are called promoters.

   Steps in Promotion

   i. Approval of company's name is taken from the Registrar of Companies

   ii. Signatories to the Memorandum of Association are fixed

   iii. Certain professionals are appropriated to assist the promoters

   iv. Documents necessary for registration are prepared

   Necessary Documents

   a. Memorandum of Association

   b. Articles of Association

   c. Consent of proposed directors

   d. Agreement, if any, with proposed managing or whole time director

   e. Statutory declaration

2. **Incorporation:** An application is made by promoters to the Registrar of Companies alongwith necessary documents and registration fee. The Registrar, after due scrutiny, issues certificate of incorporation. The certificate of incorporation is a conclusive evidence of the legal existence of the company.

3. **Capital Subscription:** A public company raising funds from the public needs to take following steps for fundraising:

(i) SEBI approval;

(ii) File a copy of prospectus with the Registrar of Companies;

(iii) Appointment of brokers, bankers and underwriters etc.;

(iv) Ensure that minimum subscription is received;

(v) Application for listing of company's securities;

(vi) Refund/adjust excess application money received;

(vii) Issue allotment letters to successful applicants; and

(viii) File return of allotment with the Registrar of Companies (ROC).

A public company, raising funds, raising funds from friends/relatives (not public) has to file a statement in lieu of prospectus with the ROC at least three days before allotment of shares and returns of allotment after completing the allotment. As per the SEBI guidelines, minimum subcription has to be 90% of the shares to be issued to be public.

Preliminary Contracts: Contracts signed by promoters with third parties before the incorporation of company.

Provisional Contracts: Contracts signed after incorporation but before commencement of business.

EXERCISES

Multiple Choice Questions

1. Minimum number of members to form a private company is

(a) 2	(b) 3
(c) 5	(d) 7

2. Minimum number of members to form a public company is

(a) 5	(b) 7
(c) 12	(d) 21

3. Application for approval of name of a company is to be made to

(a) SEBI	(b) Registrar of Companies
(c) Government of India	(d) Government of the State in which Company is to be registered

4. A proposed name of Company is considered undesirable if
   - (a) It is identical with the name of an existing company
   - (b) It resembles closely with the name of an existing company
   - (c) It is an emblem of Government of India, United Nations etc.
   - (d) In case of any of the above
5. A prospectus is issued by
   - (a) A private company
   - (b) A public company seeking investment from public
   - (c) A public enterprise
   - (d) A public company
6. Stages in the formation of a public company are in the following order
   - (a) Promotion, Commencement of Business, Capital Subscription, Incorporation,
   - (b) Incorporation, Capital Subscription, Promotion
   - (c) Promotion, Incorporation, Capital Subscription,
   - (d) Capital Subscription, Promotion, Incorporation,
7. Preliminary Contracts are signed
   - (a) Before the incorporation
   - (b) After incorporation but before capital subscription
   - (c) After incorporation but before commencement of business
   - (d) After commencement of business
8. Preliminary Contracts are
   - (a) binding on the Company
   - (b) binding on the Company, if ratified after incorporation
   - (c) binding on the Company, after incorporation
   - (d) not binding on the Company

True/False Answer Questions

1. It is necessary to get every company incorporated, whether private or public.
2. Statement in lieu of prospectus can be filed by a public company going for a public issue.
3. A company can commence business after incorporation.
4. Experts who help promoters in the promotion of a company are also called promoters.
5. A company can ratify preliminary contracts after incorporation.

6. If a company is registered on the basis of fictitious names, its incorporation is invalid.
7. 'Articles of Association' is the main document of a company.
8. Every company must file Articles of Association.
9. If a company suffers heavy issues and its assets are not enough to pay off its liabilities, the balance can be recovered from the private assets of its members.

Short Answer Questions

1. Name the stages in the formation of a company.
2. List the documents required for the incorporation of a company.
3. What is a prospectus? Is it necessary for every company to file a prospectus?
4. Briefly explain the term 'Return of Allotment'.
5. At which stage in the formation of a company does it interact with SEBI.

Long Answer Questions

1. What is meant by the term 'Promotion'. Discuss the legal position of promoters with respect to a company promoted by them.
2. Explain the steps taken by promoters in the promotion of a company.
3. What is a 'Memorandum of Association'? Briefly explain its clauses.
4. Distinguish between 'Memorandum of Association' and 'Articles of Association.'
5. What is the meaning of 'Certificate of Incorporation'?
6. Discuss the stages of formation of a company?

Project/Assignment

Find out from the office of the Registrar of Companies, the actual procedure for formation of companies. Does it match with what you have studied. What are the obstacles which companies face in getting themselves registered.

CHAPTER 8

SOURCES OF BUSINESS FINANCE

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- state the meaning, nature and importance of business finance;
- classify the various sources of business finance;
- evaluate merits and limitations of various sources of finance;
- identify the international sources of finance; and
- examine the factors that affect the choice of an appropriate source of finance.

Mr. Anil Singh has been running a restaurant for the last two years. The excellent quality of food has made the restaurant popular in no time. Motivated by the success of his business, Mr. Singh is now contemplating the idea of opening a chain of similar restaurants at different places. However, the money available with him from his personal sources is not sufficient to meet the expansion requirements of his business. His father told him that he can enter into a partnership with the owner of another restaurant, who will bring in more funds but it would also require sharing of profits and control of business. He is also thinking of getting a bank loan. He is worried and confused, as he has no idea as to how and from where he should obtain additional funds. He discusses the problem with his friend Ramesh, who tells him about some other methods like issue of shares and debentures, which are available only to a company form of organisation. He further cautions him that each method has its own advantages and limitations and his final choice should be based on factors like the purpose and period for which funds are required. He wants to learn about these methods.

8.1 Introduction

This chapter provides an overview of the various sources from where funds can be procured for starting as also for running a business. It also discusses the advantages and limitations of various sources and points out the factors that determine the choice of a suitable source of business finance.

It is important for any person who wants to start a business to know about the different sources from where money can be raised. It is also important to know the relative merits and demerits of different sources so that choice of an appropriate source can be made.

8.2 Meaning, Nature and Significance of Business Finance

Business is concerned with the production and distribution of goods and services for the satisfaction of needs of society. For carrying out various activities, business requires money. Finance, therefore, is called the life blood of any business. The requirements of funds by business to carry out its various activities is called business finance.

A business cannot function unless adequate funds are made available to it. The initial capital contributed by the entrepreneur is not always sufficient to take care of all financial requirements of the business. A business person, therefore, has to look for different other sources from where the need for funds can be met. A clear assessment of the financial needs and the identification of various sources of finance, therefore, is a significant aspect of running a business organisation.

The need for funds arises from the stage when an entrepreneur makes a decision to start a business. Some funds are needed immediately say for the purchase of plant and machinery, furniture, and other fixed assets. Similarly, some funds are required for day-to-day operations, say to purchase raw materials, pay salaries to employees, etc. Also when the business expands, it needs funds.

The financial needs of a business can be categorised as follows:

(a) **Fixed capital requirements:** In order to start business, funds are required to purchase fixed assets like land and building, plant and machinery, and furniture and fixtures. This is known as fixed capital requirements of the enterprise. The funds required in fixed assets remain invested in the business for a long period of time. Different business units need varying amount of fixed capital depending on various factors such as the nature of business, etc. A trading concern for example, may require small amount of fixed capital as compared to a manufacturing concern. Likewise, the need for fixed capital investment would be greater for a large enterprise, as compared to that of a small enterprise.

(b) **Working Capital requirements:** The financial requirements of an enterprise do not end with the procurement of fixed assets. No matter how small or large a business is, it needs funds for its day-to-day operations. This is known as working capital of an enterprise, which is used for holding current assets such as stock of material, bills receivables and for meeting current expenses like salaries, wages, taxes, and rent.

The amount of working capital required varies from one business concern to another depending on various factors. A business unit selling goods on credit, or having a slow sales turnover, for example, would require more working capital as compared to a concern selling its goods and services on cash basis or having a speedier turnover.

The requirement for fixed and working capital increases with the growth and expansion of business. At times additional funds are required for upgrading the technology employed so that the cost of production or operations can be reduced. Similarly, larger funds may be required for building higher inventories for the festive season or to meet current debts or expand the business or to shift to a new location. It is, therefore, important to evaluate the different sources from where funds can be raised.

8.3 Classification of Sources of Funds

In case of proprietary and partnership concerns, the funds may be raised either from personal sources or borrowings from banks, friends etc. In case of company form of organisation, the different sources of business finance which are available may be categorised as given in Table 8.1

As shown in the table, the sources of funds can be categorised using different basis viz., on the basis of the period, source of generation and the ownership. A brief explanation of these classifications and the sources is provided as follows:

Table 8.1 Classification of Sources of Funds

Source of Funds Classification

- On the basis of period
  - **Long-term**
    - Equity shares
    - Retained earnings
    - Preference shares
    - Debentures
    - Loan from financial institutions
    - Loan from banks
  - **Medium-term**
    - Loan from banks
    - Public deposits
    - Loan from financial Institutions
    - Lease financing
  - **Short-term**
    - Trade credit
    - Factoring
    - Banks
    - Commercial paper
- On the basis of ownership
  - **Owner's Funds**
    - Equity shares
    - Retained earnings
  - **Borrowed Funds**
    - Debentures
    - Loans from banks
    - Loans from financial institutions
    - Public deposits
    - Lease financing
    - Commercial Papers
- On the basis of source of generation
  - **Internal Sources**
    - Equity share capital
    - Retained earnings
  - **External Sources**
    - Financial institutions
    - Loan from banks
    - Preference shares
    - Public deposits
    - Debenture
    - Lease financing
    - Commercial papers
    - Trade credit
    - Factoring

8.3.1 Period Basis

On the basis of period, the different sources of funds can be categorised into three parts. These are long-term sources, medium-term sources and short-term sources.

The long-term sources fulfil the financial requirements of an enterprise for a period exceeding 5 years and include sources such as shares and debentures, long-term borrowings and loans from financial institutions. Such financing is generally required for the acquisition of fixed assets such as equipment, plant, etc.

Where the funds are required for a period of more than one year but less than five years, medium-term sources of finance are used. These sources include borrowings from commercial banks, public deposits, lease financing and loans from financial institutions.

Short-term funds are those which are required for a period not exceeding one year. Trade credit, loans from commercial banks and commercial papers are some of the examples of the sources that provide funds for short duration.

Short-term financing is most common for financing of current assets such as accounts receivable and inventories. Seasonal businesses that must build inventories in anticipation of selling requirements often need short-term financing for the interim period between seasons. Wholesalers and manufacturers with a major portion of their assets tied up in inventories or receivables also require large amount of funds for a short period.

8.3.2 Ownership Basis

On the basis of ownership, the sources can be classified into 'owner's funds' and 'borrowed funds'. Owner's funds means funds that are provided by the owners of an enterprise, which may be a sole trader or partners or shareholders of a company. Apart from capital, it also includes profits reinvested in the business. The owner's capital remains invested in the business for a longer duration and is not required to be refunded during the life period of the business. Such capital forms the basis on which owners acquire their right of control of management. Issue of equity shares and retained earnings are the two important sources from where owner's funds can be obtained.

'Borrowed funds' on the other hand, refer to the funds raised through loans or borrowings. The sources for raising borrowed funds include loans from commercial banks, loans from financial institutions, issue of debentures, public deposits and trade credit. Such sources provide funds for a specified period, on certain terms and conditions and have to be repaid after the expiry of that period. A fixed rate of interest is paid by the borrowers on such funds. At times it puts a lot of burden on the business as payment of interest is to be made even when the earnings are low or when loss is incurred. Generally, borrowed funds are provided on the security of some fixed assets.

8.3.3 Source of Generation Basis

Another basis of categorising the sources of funds can be whether the funds are generated from within the organisation or from external sources. Internal sources of funds are those that are generated from within the business. A business, for example, can generate funds internally by accelerating collection of receivables, disposing of surplus inventories and ploughing back its profit. The internal sources of funds can fulfill only limited needs of the business.

External sources of funds include those sources that lie outside an organisation, such as suppliers, lenders, and investors. When large amount of money is required to be raised, it is generally done through the use of external sources. External funds may be costly as compared to those raised through internal sources. In some cases, business is required to mortgage its assets as security while obtaining funds from external sources. Issue of debentures, borrowing from commercial banks and financial institutions and accepting public deposits are some of the examples of external sources of funds commonly used by business organisations.

8.4 Sources of Finance

A business can raise funds from various sources. Each of the source has unique characteristics, which must be properly understood so that the best available source of raising funds can be identified. There is not a single best source of funds for all organisations. Depending on the situation, purpose, cost and associated risk, a choice may be made about the source to be used. For example, if a business wants to raise funds for meeting fixed capital requirements, long term funds may be required which can be raised in the form of owned funds or borrowed funds. Similarly, if the purpose is to meet the day-to-day requirements of business, the short term sources may be tapped. A brief description of various sources, along with their advantages and limitations is given below.

8.4.1 Retained Earnings

A company generally does not distribute all its earnings amongst the shareholders as dividends. A portion of the net earnings may be retained in the business for use in the future. This is known as retained earnings. It is a source of internal financing or self-financing or 'ploughing back of profits'. The profit available for ploughing back in an organisation depends on many factors like net profits, dividend policy and age of the organisation.

Merits

The merits of retained earning as a source of finance are as follows:

(i) Retained earnings is a permanent source of funds available to an organisation;
(ii) It does not involve any explicit cost in the form of interest, dividend or floatation cost;
(iii) As the funds are generated internally, there is a greater degree of operational freedom and flexibility;

(iv) It enhances the capacity of the business to absorb unexpected losses;
(v) It may lead to increase in the market price of the equity shares of a company.

Limitations

Retained earning as a source of funds has the following limitations:
(i) Excessive ploughing back may cause dissatisfaction amongst the shareholders as they would get lower dividends;
(ii) It is an uncertain source of funds as the profits of business are fluctuating;
(iii) The opportunity cost associated with these funds is not recognised by many firms. This may lead to sub-optimal use of the funds.

8.4.2 Trade Credit

Trade credit is the credit extended by one trader to another for the purchase of goods and services. Trade credit facilitates the purchase of supplies without immediate payment. Such credit appears in the records of the buyer of goods as 'sundry creditors' or 'accounts payable'. Trade credit is commonly used by business organisations as a source of short-term financing. It is granted to those customers who have reasonable amount of financial standing and goodwill. The volume and period of credit extended depends on factors such as reputation of the purchasing firm, financial position of the seller, volume of purchases, past record of payment and degree of competition in the market. Terms of trade credit may vary from one industry to another and from one person to another. A firm may also offer different credit terms to different customers.

Merits

The important merits of trade credit are as follows:
(i) Trade credit is a convenient and continuous source of funds;
(ii) Trade credit may be readily available in case the credit worthiness of the customers is known to the seller;
(iii) Trade credit needs to promote the sales of an organisation;
(iv) If an organisation wants to increase its inventory level in order to meet expected rise in the sales volume in the near future, it may use trade credit to, finance the same;
(v) It does not create any charge on the assets of the firm while providing funds.

Limitations

Trade credit as a source of funds has certain limitations, which are given as follows:
(i) Availability of easy and flexible trade credit facilities may induce a firm to indulge in overtrading, which may add to the risks of the firm;
(ii) Only limited amount of funds can be generated through trade credit;
(iii) It is generally a costly source of funds as compared to most other sources of raising money.

8.4.3 Factoring

Factoring is a financial service under which the 'factor' renders various services which includes:

(a) Discounting of bills (with or without recourse) and collection of the client's debts. Under this, the receivables on account of sale of goods or services are sold to the factor at a certain discount. The factor becomes responsible for all credit control and debt collection from the buyer and provides protection against any bad debt losses to the firm. There are two methods of factoring — recourse and non-recourse. Under recourse factoring, the client is not protected against the risk of bad debts. On the other hand, the factor assumes the entire credit risk under non-recourse factoring i.e., full amount of invoice is paid to the client in the event of the debt becoming bad.

(b) Providing information about credit worthiness of prospective client's etc., Factors hold large amounts of information about the trading histories of the firms. This can be valuable to those who are using factoring services and can thereby avoid doing business with customers having poor payment record. Factors may also offer relevant consultancy services in the areas of finance, marketing, etc.

The factor charges fees for the services rendered. Factoring appeared on the Indian financial scene only in the early nineties as a result of RBI initiatives. The organisations that provides such services include SBI Factors and Commercial Services Ltd., Canbank Factors Ltd., Foremost Factors Ltd., State Bank of India, Canara Bank, Punjab National Bank, Allahabad Bank. In addition, many non-banking finance companies and other agencies provide factoring service.

Merits

The merits of factoring as a source of finance are as follows:

(i) Obtaining funds through factoring is cheaper than financing through other means such as bank credit;
(ii) With cash flow accelerated by factoring, the client is able to meet his/her liabilities promptly as and when these arise;
(iii) Factoring as a source of funds is flexible and ensures a definite pattern of cash inflows from credit sales. It provides security for a debt that a firm might otherwise be unable to obtain;
(iv) It does not create any charge on the assets of the firm;
(v) The client can concentrate on other functional areas of business as the responsibility of credit control is shouldered by the factor.

Limitations

The limitations of factoring as a source of finance are as follows:

(i) This source is expensive when the invoices are numerous and smaller in amount;
(ii) The advance finance provided by the factor firm is generally available at a higher interest cost than the usual rate of interest;

(iii) The factor is a third party to the customer who may not feel comfortable while dealing with it.

8.4.4 Lease Financing

A lease is a contractual agreement whereby one party i.e., the owner of an asset grants the other party the right to use the asset in return for a periodic payment. In other words it is a renting of an asset for some specified period. The owner of the assets is called the 'lessor' while the party that uses the assets is known as the 'lessee' (see Box A). The lessee pays a fixed periodic amount called lease rental to the lessor for the use of the asset. The terms and conditions regulating the lease arrangements are given in the lease contract. At the end of the lease period, the asset goes back to the lessor. Lease finance provides an important means of modernisation and diversification to the firm. Such type of financing is more prevalent in the acquisition of such assets as computers and electronic equipment which become obsolete quicker because of the fast changing technological developments. While making the leasing decision, the cost of leasing an asset must be compared with the cost of owning the same.

Merits

The important merits of lease financing are as follows:

(i) It enables the lessee to acquire the asset with a lower investment;
(ii) Simple documentation makes it easier to finance assets;
(iii) Lease rentals paid by the lessee are deductible for computing taxable profits;
(iv) It provides finance without diluting the ownership or control of business;
(v) The lease agreement does not affect the debt raising capacity of an enterprise;
(vi) The risk of obsolescence is borne by the lesser. This allows greater flexibility to the lessee to replace the asset.

Limitations

The limitations of lease financing are given as below:

(i) A lease arrangement may impose certain restrictions on the use of assets. For example, it may not allow the lessee to make any alteration or modification in the asset;
(ii) The normal business operations may be affected in case the lease is not renewed;
(iii) It may result in higher payout obligation in case the equipment is not found useful and the lessee opts for premature termination of the lease agreement; and
(iv) The lessee never becomes the owner of the asset. It deprives him of the residual value of the asset.

8.4.5 Public Deposits

The deposits that are raised by organisations directly from the public are known as public deposits. Rates of interest offered on public deposits are usually higher than that offered on bank deposits. Any person who is interested in depositing money in an organisation can do so by filling up a prescribed form. The organisation in return issues a deposit receipt as acknowledgment of the debt. Public deposits can take care of both medium and short-term financial requirements of a business. The deposits are beneficial to both the depositor as well as to the organisation. While the depositors get higher interest rate than that offered by banks, the cost of deposits to the company is less than the cost of borrowings from banks. Companies generally invite public deposits for a period upto three years. The acceptance of public deposits is regulated by the Reserve Bank of India.

Box A

The Lessors

1. **Specialised leasing companies:** There are about 400-odd large companies which have an organisational focus on leasing, and hence, are known as leasing companies.
2. **Banks and bank-subsidiaries:** In February 1994, the RBI allowed banks to directly enter leasing. Till then, only bank subsidiaries were allowed to engage in leasing operations, which was regarded by the RBI as a non-banking activity.
3. **Specialised financial institutions:** A number of financial institutions, at the Central as well as the State level in India, use the lease instrument along with traditional financing instruments. Significantly, the ICICI is one of the pioneers in Indian leasing.
4. **Manufacturer-lessors:** As competition forces the manufacturer to add value to his sales, he finds the best way to sell the product on lease. Vendor leasing is gaining increasing importance. Presently, vendors of automobiles, consumer durables, etc., have alliances or joint ventures with leasing companies to offer lease finance against their products.

The Lessees

1. **Public sector undertakings:** This market has witnessed a good rate of growth in the past. There is an increasing number of both centrally as well as State-owned entities which have resorted to lease financing.
2. **Mid-market companies:** The mid-market companies (i.e., companies with reasonably good creditworthiness but with lower public profile) have resorted to lease financing basically as an alternative to bank/institutional financing.
3. **Consumers:** Recent bad experience with corporate financing has focussed attention towards retail funding of consumer durables. For instance, car leasing is a big market in India today.
4. **Government deptts. and authorities:** One of the latest entrants in leasing markets is the government itself. Recently the Department of Telecommunications of the central government took the lead by floating tenders for lease finance worth about Rs. 1000 crores.

Merits

The merits of public deposits are:

(i) The procedure of obtaining deposits is simple and does not contain restrictive conditions as are generally there in a loan agreement;

(ii) Cost of public deposits is generally lower than the cost of borrowings from banks and financial institutions;

(iii) Public deposits do not usually create any charge on the assets of the company. The assets can be used as security for raising loans from other sources;

(iv) As the depositors do not have voting rights, the control of the company is not diluted.

Limitations

The major limitation of public deposits are as follows:

(i) New companies generally find it difficult to raise funds through public deposits;

(ii) It is an unreliable source of finance as the public may not respond when the company needs money;

(iii) Collection of public deposits may prove difficult, particularly when the size of deposits required is large.

8.4.6 Commercial Paper (CP)

Commercial Paper emerged as a source of short term finance in our country in the early nineties. Commercial paper is an unsecured promissory note issued by a firm to raise funds for a short period, varying from 90 days to 364 days. It is issued by one firm to other business firms, insurance companies, pension funds and banks. The amount raised by CP is generally very large. As the debt is totally unsecured, the firms having good credit rating can issue the CP. Its regulation comes under the purview of the Reserve Bank of India.

The merits and limitations of a Commercial Paper are as follows:

Merits

(i) A commercial paper is sold on an unsecured basis and does not contain any restrictive conditions;

(ii) As it is a freely transferable instrument, it has high liquidity;

(iii) It provides more funds compared to other sources. Generally, the cost of CP to the issuing firm is lower than the cost of commercial bank loans;

(iv) A commercial paper provides a continuous source of funds. This is because their maturity can be tailored to suit the requirements of the issuing firm. Further, maturing commercial paper can be repaid by selling new commercial paper;

(v) Companies can park their excess funds in commercial paper thereby earning some good return on the same.

Limitations

(i) Only financially sound and highly rated firms can raise money through commercial papers. New and moderately rated firms are not in a position to raise funds by this method;

(ii) The size of money that can be raised through commercial paper is limited to the excess liquidity available with the suppliers of funds at a particular time;

(iii) Commercial paper is an impersonal method of financing. As such if a firm is not in a position to redeem its paper due to financial difficulties, extending the maturity of a CP is not possible.

8.4.7 Issue of Shares

The capital obtained by issue of shares is known as share capital. The capital of a company is divided into small units called shares. Each share has its nominal value. For example, a company can issue 1,00,000 shares of Rs. 10 each for a total value of Rs. 10,00,000. The person holding the share is known as shareholder. There are two types of shares normally issued by a company. These are equity shares and preference shares. The money raised by issue of equity shares is called equity share capital, while the money raised by issue of preference shares is called preference share capital.

(a) Equity Shares

Equity shares is the most important source of raising long term capital by a company. Equity shares represent the ownership of a company and thus the capital raised by issue of such shares is known as ownership capital or owner's funds. Equity share capital is a prerequisite to the creation of a company. Equity shareholders do not get a fixed dividend but are paid on the basis of earnings by the company. They are referred to as 'residual owners' since they receive what is left after all other claims on the company's income and assets have been settled. They enjoy the reward as well as bear the risk of ownership. Their liability, however, is limited to the extent of capital contributed by them in the company. Further, through their right to vote, these shareholders have a right to participate in the management of the company.

Merits

The important merits of raising funds through issuing equity shares are given as below:

(i) Equity shares are suitable for investors who are willing to assume risk for higher returns;

(ii) Payment of dividend to the equity shareholders is not compulsory. Therefore, there is no burden on the company in this respect;

(iii) Equity capital serves as permanent capital as it is to be repaid only at the time of liquidation of a company. As it stands last in the list of claims, it provides a cushion for creditors, in the event of winding up of a company;

(iv) Equity capital provides credit worthiness to the company and confidence to prospective loan providers;

(v) Funds can be raised through equity issue without creating any charge on the assets of the company. The assets of a company are, therefore, free to be mortgaged for the purpose of borrowings, if the need be;

(vi) Democratic control over management of the company is assured due to voting rights of equity shareholders.

Limitations

The major limitations of raising funds through issue of equity shares are as follows:

(i) Investors who want steady income may not prefer equity shares as equity shares get fluctuating returns;

(ii) The cost of equity shares is generally more as compared to the cost of raising funds through other sources;

(iii) Issue of additional equity shares dilutes the voting power, and earnings of existing equity shareholders;

(iv) More formalities and procedural delays are involved while raising funds through issue of equity share.

(b) Preference Shares

The capital raised by issue of preference shares is called preference share capital. The preference shareholders enjoy a preferential position over equity shareholders in two ways: (i) receiving a fixed rate of dividend, out of the net profits of the company, before any dividend is declared for equity shareholders; and (ii) receiving their capital after the claims of the company's creditors have been settled, at the time of liquidation. In other words, as compared to the equity shareholders, the preference shareholders have a preferential claim over dividend and repayment of capital. Preference shares resemble debentures as they bear fixed rate of return. Also as the dividend is payable only at the discretion of the directors and only out of profit after tax, to that extent, these resemble equity shares. Thus, preference shares have some characteristics of both equity shares and debentures. Preference shareholders generally do not enjoy any voting rights. A company can issue different types of preference shares (see Box B).

Merits

The merits of preference shares are given as follows:

(i) Preference shares provide reasonably steady income in the form of fixed rate of return and safety of investment;

(ii) Preference shares are useful for those investors who want fixed rate of return with comparatively low risk;

(iii) It does not affect the control of equity shareholders over the management as preference shareholders don't have voting rights;

(iv) Payment of fixed rate of dividend to preference shares may enable a company to declare higher rates of dividend for the equity shareholders in good times;

(v) Preference shareholders have a preferential right of repayment over equity shareholders in the event of liquidation of a company;

(vi) Preference capital does not create any sort of charge against the assets of a company.

Limitations

The major limitations of preference shares as source of business finance are as follows:

(i) Preference shares are not suitable for those investors who are willing to take risk and are interested in higher returns;

(ii) Preference capital dilutes the claims of equity shareholders over assets of the company;

(iii) The rate of dividend on preference shares is generally higher than the rate of interest on debentures;

(iv) As the dividend on these shares is to be paid only when the company earns profit, there is no assured return for the investors. Thus, these shares may not be very attractive to the investors;

(v) The dividend paid is not deductible from profits as expense. Thus, there is no tax saving as in the case of interest on loans.

8.4.8 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 debenture issued by a company is an acknowledgment that the company has borrowed a certain amount of money, which it promises to repay at a future date. Debenture holders are, therefore, termed as creditors of the company. Debenture holders are paid a fixed stated amount of interest at specified

Box B
Types of Preference Shares

1. **Cumulative and Non-Cumulative:** The preference shares which enjoy the right to accumulate unpaid dividends in the future years, in case the same is not paid during a year are known as cumulative preference shares. On the other hand, on non-cumulative shares, dividend is not accumulated if it is not paid in a particular year.

2. **Participating and Non-Participating:** Preference shares which have a right to participate in the further surplus of a company shares which after dividend at a certain rate has been paid on equity shares are called participating preference shares. The non-participating preference are such which do not enjoy such rights of participation in the profits of the company.

3. **Convertible and Non-Convertible:** Preference shares that can be converted into equity shares within a specified period of time are known as convertible preference shares. On the other hand, non-convertible shares are such that cannot be converted into equity shares.

intervals say six months or one year. Public issue of debentures requires that the issue be rated by a credit rating agency like CRISIL (Credit Rating and Information Services of India Ltd.) on aspects like track record of the company, its profitability, debt servicing capacity, credit worthiness and the perceived risk of lending. A company can issue different types of debentures (see Box C and D). Issue of Zero Interest Debentures (ZID) which do not carry any explicit rate of interest has also become popular in recent years. The difference between the face value of the debenture and its purchase price is the return to the investor.

Merits

The merits of raising funds through debentures are given as follows:

(i) It is preferred by investors who want fixed income at lesser risk;
(ii) Debentures are fixed charge funds and do not participate in profits of the company;
(iii) The issue of debentures is suitable in the situation when the sales and earnings are relatively stable;
(iv) As debentures do not carry voting rights, financing through debentures does not dilute control of equity shareholders on management;
(v) Financing through debentures is less costly as compared to cost of preference or equity capital as the interest payment on debentures is tax deductible.

Limitations

Debentures as source of funds has certain limitations. These are given as follows:

(i) As fixed charge instruments, debentures put a permanent burden on the earnings of a company. There is a greater risk when earnings of the company fluctuate;
(ii) In case of redeemable debentures, the company has to make provisions for repayment on the specified date, even during periods of financial difficulty;
(iii) Each company has certain borrowing capacity. With the issue of debentures, the capacity of a company to further borrow funds reduces.

8.4.9 Commercial Banks

Commercial banks occupy a vital position as they provide funds for different purposes as well as for different time periods. Banks extend loans to firms of all sizes and in many ways, like, cash credits, overdrafts, term loans, purchase/discounting of bills, and issue of letter of credit. The rate of interest charged by banks depends on various factors such as the characteristics of the firm and the level of interest rates in the economy. The loan is repaid either in lump sum or in installments.

Bank credit is not a permanent source of funds. Though banks have started extending loans for longer periods, generally such loans are used for medium to short periods. The borrower is required to provide some security or create a charge on the assets of the firm before a loan is sanctioned by a commercial bank.

Merits

The merits of raising funds from a commercial bank are as follows:

(i) Banks provide timely assistance to business by providing funds as and when needed by it.
(ii) Secrecy of business can be maintained as the information supplied to the bank by the borrowers is kept confidential;
(iii) Formalities such as issue of prospectus and underwriting are not required for raising loans from a bank. This, therefore, is an easier source of funds;
(iv) Loan from a bank is a flexible source of finance as the loan amount can be increased according to business needs and can be repaid in advance when funds are not needed.

Limitations

The major limitations of commercial banks as a source of finance are as follows:

(i) Funds are generally available for short periods and its extension or renewal is uncertain and difficult;
(ii) Banks make detailed investigation of the company's affairs, financial structure etc., and may also ask for security of assets and personal sureties. This makes the procedure of obtaining funds slightly difficult;

Box C
Types of Debentures

1. **Secured and Unsecured:** Secured debentures are such which create a charge on the assets of the company, thereby mortgaging the assets of the company. Unsecured debentures on the other hand do not carry any charge or security on the assets of the company.
2. **Registered and Bearer:** Registered debentures are those which are duly recorded in the register of debenture holders maintained by the company. These can be transferred only through a regular instrument of transfer. In contrast, the debentures which are transferable by mere delivery are called bearer debentures.
3. **Convertible and Non-Convertible:** Convertible debentures are those debentures that can be converted into equity shares after the expiry of a specified period. On the other hand, non-convertible debentures are those which cannot be converted into equity shares.
4. **First and Second:** Debentures that are repaid before other debentures are repaid are known as first debentures. The second debentures are those which are paid after the first debentures have been paid back.

(iii) In some cases, difficult terms and conditions are imposed by banks. for the grant of loan. For example, restrictions may be imposed on the sale of mortgaged goods, thus making normal business working difficult.

8.4.10 Financial Institutions

The government has established a number of financial institutions all over the country to provide finance to business organisations (see Box E). These institutions are established by the central as well as state governments. They provide both owned capital and loan capital for long and medium term requirements and supplement the traditional financial agencies like commercial banks. As these institutions aim at promoting the industrial development of a country, these are also called 'development banks'. In addition to providing financial assistance, these institutions also conduct market surveys and provide technical assistance and managerial services to people who run the enterprises. This source of financing is considered suitable when large funds for longer duration are required for expansion, reorganisation and modernisation of an enterprise.

Merits

The merits of raising funds through financial institutions are as follows:

(i) Financial institutions provide long-term finance, which are not provided by commercial banks;

(ii) Besides providing funds, many of these institutions provide financial, managerial and technical advice and consultancy to business firms;

(iii) Obtaining loan from financial institutions increases the goodwill of the borrowing company in the capital market. Consequently, such a company can raise funds easily from other sources as well;

(iv) As repayment of loan can be made in easy instalments, it does not prove to be much of a burden on the business;

(v) The funds are made available even during periods of depression, when other sources of finance are not available.

Limitations

The major limitations of raising funds from financial institutions are as given below:

(i) Financial institutions follow rigid criteria for grant of loans. Too many formalities make the procedure time consuming and expensive;

(ii) Certain restrictions such as restriction on dividend payment are imposed on the powers of the borrowing company by the financial institutions;

(iii) Financial institutions may have their nominees on the Board of Directors of the borrowing company thereby restricting the powers of the company.

Box D
Special Financial Institutions

1. **Industrial Finance Corporation of India (IFCI):** It was established in July 1948 as a statutory corporation under the Industrial Finance Corporation Act, 1948. Its objectives include assistance towards balanced regional development and encouraging new entrepreneurs to enter into the priority sectors of the economy. IFCI has also contributed to the development of management education in the country.
2. **State Financial Corporations (SFC):** The State Financial Corporations Act, 1951 empowered the State Governments to establish State Financial Corporations in their respective regions for providing medium and short term finance to industries which are outside the scope of the IFCI. Its scope is wider than IFCI, since the former covers not only public limited companies but also private limited companies, partnership firms and proprietary concerns.
3. **Industrial Credit and Investment Corporation of India (ICICI):** This was established in 1955 as a public limited company under the Companies Act. ICICI assists the creation, expansion and modernisation of industrial enterprises exclusively in the private sector. The corporation has also encouraged the participation of foreign capital in the country.
4. **Industrial Development Bank of India (IDBI):** It was established in 1964 under the Industrial Development Bank of India Act, 1964 with an objective to coordinate the activities of other financial institutions including commercial banks. The bank performs three types of functions, namely, assistance to other financial institutions, direct assistance to industrial concerns, and promotion and coordination of financial-technical services.
5. **State Industrial Development Corporations (SIDC):** Many state governments have set up State Industrial Development Corporations for the purpose of promoting industrial development in their respective states. The objectives of the SIDCs differ from one state to another.
6. **Unit Trust of India (UTI):** It was established by the Government of India in 1964 under the Unit Trust of India Act, 1963. The basic objective of UTI is to mobilise the community's savings and channelise them into productive ventures. For this purpose, it sanctions direct assistance to industrial concerns, invests in their shares and debentures, and participates with other financial institutions.
7. **Industrial Investment Bank of India Ltd.:** It was initially set up as a primary agency for rehabilitation of sick units and was known as Industrial Reconstruction Corporation of India. It was reconstituted and renamed as the Industrial Reconstruction Bank of India in 1985 and again in 1997 its name was changed to Industrial Investment Bank of India. The Bank assists sick units in the reorganisation of their share capital, improvement in management system, and provision of finance at liberal terms.
8. **Life Insurance Corporation of India (LIC):** LIC was set up in 1956 under the LIC Act, 1956 after nationalising 245 existing insurance companies. It mobilises the community's savings in the form of insurance premia and makes it available to industrial concerns, both public as well as private, in the form of direct loans and underwriting of and subscription to shares and debentures.

BOX E

Inter Corporate Deposits (ICD)

Inter Corporate Deposits are unsecured short-term deposits made by a company with another company. ICD market is used for short-term cash management of a large corporate. As per the RBI guidelines, the minimum period of ICDs is 7 days which can be extended to one year.

The three types of Inter Corporate Deposits are:
(i) Three months deposits;
(ii) Six months deposits;
(iii) Call deposits.

Interest rate on ICDs may remain fixed or may be floating. The rate of interest on these deposits is higher than that of banks. These deposits are usually considered by the borrower company to solve problems of short-term funds insufficiency.

8.5 International Financing

In addition to the sources discussed above, there are various avenues for organisations to raise funds internationally. With the opening up of an economy and the operations of the business organisations becoming global, Indian companies have an access to funds in global capital market. Various international sources from where funds may be generated include:

(i) Commercial Banks: Commercial banks all over the world extend foreign currency loans for business purposes. They are an important source of financing non-trade international operations. The types of loans and services provided by banks vary from country to country. For example, Standard Chartered emerged as a major source of foreign currency loans to the Indian industry.

(ii) International Agencies and Development Banks: A number of international agencies and development banks have emerged over the years to finance international trade and business. These bodies provide long and medium term loans and grants to promote the development of economically backward areas in the world. These bodies were set up by the Governments of developed countries of the world at national, regional and international levels for funding various projects. The more notable among them include International Finance Corporation (IFC), EXIM Bank and Asian Development Bank.

(iii) International Capital Markets: Modern organisations including multinational companies depend upon sizeable borrowings in rupees as well as in foreign currency. Prominent financial instruments used for this purpose are:

(a) Global Depository Receipts (GDR's): The local currency shares of a company are delivered to the depository bank. The depository bank issues depository receipts against these shares. Such depository receipts denominated in US dollars are known as Global Depository Receipts (GDR). GDR is a negotiable instrument and can be traded freely like any other security. In the Indian context, a GDR is an instrument issued abroad by an Indian company to raise funds in some foreign currency and is listed and traded on a foreign stock exchange. A holder of GDR can at any time convert it into the number of shares it represents. The holders of GDRs do not carry any voting rights but only dividends and capital appreciation. Many Indian companies such as Infosys, Reliance, Wipro and ICICI have raised money through issue of GDRs (see Box F).

(b) **American Depository Receipts (ADRs):** The depository receipts issued by a company in the USA are known as American Depository Receipts. ADRs are bought and sold in American markets, like regular stocks. It is similar to a GDR except that it can be issued only to American citizens and can be listed and traded on a stock exchange of USA.

(c) **Indian Depository Receipt (IDRs):** An Indian Depository Receipt is a financial instrument denominated in Indian Rupees in the form of a Depository Receipt. It is created by an Indian Depository to enable a foreign company to raise funds from the Indian securities market. The IDR is a

Box F
Companies rush to float GDR issues

It's not the IPO (initial public offer) market alone which is humming with activity. Companies — mostly small and medium-sized — are rushing to the overseas market to raise funds through Global Depository Receipts (GDRs). Five firms have already raised $464 million (around Rs 2,040 crore) from the international markets through GDR offerings this year. This is almost double of $228.6 mn raised by nine companies in 2004 and $63.09 mn mobilised by four companies in 2003. Nearly 20 companies are waiting in the wings to launch GDR issues worth over $1 bn in the coming months. On the other hand, though the number of companies going for FCCB (Foreign Currency Convertible Bonds) issues has come down, several companies are still in the FCCB race, thanks to lax rules and disclosure norms. For example, Aarti Drugs Ltd. has decided to raise $12 mn by issuing FCCBs.

Significantly, small and medium companies are now taking the GDR route to raise funds this time even for a small amount. For example, Opto Circuits has decided to go for a GDR issue of $20 mn with a green-shoe option of $5 mn. The share price of this company shot up by 370 per cent from Rs 34 on May 17, 2004 to around Rs 160 on the BSE recently. Videocon Industries, Lyka Labs, Indian Overseas Bank, Jubilant Organosys, Maharashtra Seamless, Moschip Semiconductors, and Crew BOS are planning GDR issues. Two banks — UTI Bank ($240 million) and Centurion Bank ($70 million) — raised funds from the GDR market recently. Companies now prefer GDR over FCCB issues in view of the rise in interest rates abroad.

specific Indian version of the similar global depository receipts.

The foreign company issuing IDR deposits shares to an Indian Depository (custodian of securities registered with the Securities and Exchange Board of India). In turn, the depository issues receipts to investors in India against these shares. The benefits of the underlying shares (like bonus, dividends, etc.) accrue to the IDR holders in India.

According to SEBI guidelines, IDRs are issued to Indian residents in the same way as domestic shares are issued. The issuer company makes a public offer in India, and residents can bid in exactly the same format and method as they bid for Indian shares.

'Standard Chartered PLC' was the first company that issued Indian Depository Receipt in Indian securities market in June 2010.

(d) Foreign Currency Convertible Bonds (FCCBs): Foreign currency convertible bonds are equity linked debt securities that are to be converted into equity or depository receipts after a specific period. Thus, a holder of FCCB has the option of either converting them into equity shares at a predetermined price or exchange rate, or retaining the bonds. The FCCB's are issued in a foreign currency and carry a fixed interest rate which is lower than the rate of any other similar non-convertible debt instrument. FCCB's are listed and traded in foreign stock exchanges. FCCB's are very similar to the convertible debentures issued in India.

8.6 Factors Affecting the Choice of the Source of Funds

Financial needs of a business are of different types — long term, short term, fixed and fluctuating. Therefore, business firms resort to different types of sources for raising funds. Short-term borrowings offer the benefit of reduced cost due to reduction of idle capital, but long – term borrowings are considered a necessity on many grounds. Similarly equity capital has a role to play in the scheme for raising funds in the corporate sector.

As no source of funds is devoid of limitations, it is advisable to use a combination of sources, instead of relying only on a single source. A number of factors affect the choice of this combination, making it a very complex decision for the business. The factors that affect the choice of source of finance are briefly discussed below:

(i) Cost: There are two types of cost viz., the cost of procurement of funds and cost of utilising the funds. Both these costs should be taken into account while deciding about the source of funds that will be used by an organisation.

(ii) Financial strength and stability of operations: The financial strength of a business is also a key determinant. In the choice of source of funds business should be in a sound financial position so as to be able to repay the principal amount and interest on the borrowed amount. When the earnings of the organisation are not stable, fixed charged funds like preference shares and debentures should be carefully selected as these add to the financial burden of the organisation.

(iii) **Form of organisation and legal status:** The form of business organisation and status influences the choice of a source for raising money. A partnership firm, for example, cannot raise money by issue of equity shares as these can be issued only by a joint stock company.

(iv) **Purpose and time period:** Business should plan according to the time period for which the funds are required. A short-term need for example can be met through borrowing funds at low rate of interest through trade credit, commercial paper, etc. For long term finance, sources such as issue of shares and debentures are more appropriate. Similarly, the purpose for which funds are required need to be considered so that the source is matched with the use. For example, a long-term business expansion plan should not be financed by a bank overdraft which will be required to be repaid in the short term.

(v) **Risk profile:** Business should evaluate each of the source of finance in terms of the risk involved. For example, there is a least risk in equity as the share capital has to be repaid only at the time of winding up and dividends need not be paid if no profits are available. A loan on the other hand, has a repayment schedule for both the principal and the interest. The interest is required to be paid irrespective of the firm earning a profit or incurring a loss.

(vi) **Control:** A particular source of fund may affect the control and power of the owners on the management of a firm. Issue of equity shares may mean dilution of the control. For example, as equity share holders enjoy voting rights, financial institutions may take control of the assets or impose conditions as part of the loan agreement. Thus, business firm should choose a source keeping in mind the extent to which they are willing to share their control over business.

(vii) **Effect on credit worthiness:** The dependence of business on certain sources may affect its credit worthiness in the market. For example, issue of secured debentures may affect the interest of unsecured creditors of the company and may adversely affect their willingness to extend further loans as credit to the company.

(viii) **Flexibility and ease:** Another aspect affecting the choice of a source of finance is the flexibility and ease of obtaining funds. Restrictive provisions, detailed investigation and documentation in case of borrowings from banks and financial institutions for example may be the reason that a business organisations may not prefer it, if other options are readily available.

(ix) Tax benefits: Various sources may also be weighed in terms of their tax benefits. For example, while the dividend on preference shares is not tax deductible, interest paid on debentures and loan is tax deductible and may, therefore, be preferred by organisations seeking tax advantage.

Key Terms

Finance	Owned capital	Fixed capital
Working capital	Borrowed capital	Short term sources
Restrictive conditions	Long term sources	Charge on assets
Voting power	Fixed charge funds	Accounts receivable
Bill discounting	Factoring	GDRs
FCCBs	ADRs	1CD 1DR

SUMMARY

Meaning and significance of business finance: Finance required by business to establish and run its operations is known as business finance. No business can function without adequate amount of funds for undertaking various activities. The funds are required for purchasing fixed assets (fixed capital requirement), for running day-to-day operations (working capital requirement), and for undertaking growth and expansion plans in a business organisation.

Classification of sources of funds: Various sources of funds available to a business can be classified according to three major basis, which are (i) time period (long, medium and short term), (ii) ownership (owner's funds and borrowed funds), and (iii) source of generation (internal sources and external sources).

Long, medium and short-term sources of funds: The sources that provide funds for a period exceeding 5 years are called long-term sources. The sources that fulfill the financial requirements for the period of more than one year but not exceeding 5 years are called medium term sources and the sources that provide funds for a period not exceeding one year are termed as short term sources.

Owner's funds and borrowed funds: Owner's funds refer to the funds that are provided by the owners of an enterprise. Borrowed capital, on the other hand, refers to the funds that are generated through loans or borrowings from other individuals or institutions.

Internal and external sources: Internal sources of capital are those sources that are generated within the business say through ploughing back of profits.

External sources of capital, on the other hand are those that are outside the business such as finance provided by suppliers, lenders, and investors.

Sources of business finance: The sources of funds available to a business include retained earnings, trade credit, factoring, lease financing, public deposits, commercial paper, issue of shares and debentures, loans from commercial banks, financial institutions and international sources of finance.

Retained earnings: The portion of the net earnings of the company that is not distributed as dividends is known as retained earnings. The amount of retained earnings available depends on the dividend policy of the company. It is generally used for growth and expansion of the company.

Trade credit: The credit extended by one trader to another for purchasing goods or services is known as trade credit. Trade credit facilitates the purchase of supplies on credit. The terms of trade credit vary from one industry to another and are specified on the invoice. Small and new firms are usually more dependent on trade credit, as they find it relatively difficult to obtain funds from other sources.

Factoring: Factoring has emerged as a popular source of short-term funds in recent years. It is a financial service whereby the factor is responsible for all credit control and debt collection from the buyer and provides protection against any bad-debt losses to the firm. There are two methods of factoring — recourse and non-recourse factoring.

Lease financing: A lease is a contractual agreement whereby the owner of an asset (lessor) grants the right to use the asset to the other party (lessee). The lessor charges a periodic payment for renting of an asset for some specified period called lease rent.

Public deposits: A company can raise funds by inviting the public to deposit their savings with their company. Pubic deposits may take care of both long and short-term financial requirements of business. Rate of interest on deposits is usually higher than that offered by banks and other financial institutions.

Commercial paper (CP): It is an unsecured promissory note issued by a firm to raise funds for a short period The maturity period of commercial paper usually ranges from 90 days to 364 days. Being unsecured, only firms having good credit rating can issue the CP and its regulation comes under the purview of the Reserve Bank of India.

Issue of equity shares: Equity shares represents the ownership capital of a company. Due to their fluctuating earnings, equity shareholders are called risk bearers of the company. These shareholders enjoy higher returns during prosperity and have a say in the management of a company, through exercising their voting rights.

Issue of preference shares: These shares provide a preferential right to the shareholders with respect to payment of earnings and the repayment of capital. Investors who prefer steady income without undertaking higher risks prefer these shares. A company can issue different types of preference shares.

Issue of debentures: Debenture represents the loan capital of a company and the holders of debentures are the creditors. These are the fixed charged funds that carry a fixed rate of interest. The issue of debentures is suitable in the situation when the sales and earnings of the company are relatively stable.

Commercial banks: Banks provide short and medium-term loans to firms of all sizes. The loan is repaid either in lump sum or in instalments. The rate of interest charged by a bank depends upon factors including the characteristics of the borrowing firm and the level of interest rates in the economy.

Financial institutions: Both central and state governments have established a number of financial institutions all over the country to provide industrial finance to companies engaged in business. They are also called development banks. This source of financing is considered suitable when large funds are required for expansion, reorganisation and modernisation of the enterprise.

International financing: With liberalisation and globalisation of the economy, Indian companies have started generating funds from international markets. The international sources from where the funds can be procured include foreign currency loans from commercial banks, financial assistance provided by international agencies and development banks, and issue of financial instruments (GDRs/ ADRs/ FCCBs) in international capital markets.

Factors affecting choice: An effective appraisal of various sources must be instituted by the business to achieve its main objectives. The selection of a source of business finance depends on factors such as cost, financial strength, risk profile, tax benefits and flexibility of obtaining funds. These factors should be analysed together while making the decision for the choice of an appropriate source of funds.

EXERCISES

Multiple Choice Questions

Tick (✓) the correct answer out of the given alternatives

1. Equity shareholders are called

   (a) Owners of the company (b) Partners of the company
   (c) Executives of the company (d) Guardian of the company

2. The term 'redeemable' is used for
   (a) Preference shares
   (b) Commercial paper
   (c) Equity shares
   (d) Public deposits
3. Funds required for purchasing current assets is an example of
   (a) Fixed capital requirement
   (b) Ploughing back of profits
   (c) Working capital requirement
   (d) Lease financing
4. ADRs are issued in
   (a) Canada
   (b) China
   (c) India
   (d) USA
5. Public deposits are the deposits that are raised directly from
   (a) The public
   (b) The directors
   (c) The auditors
   (d) The owners
6. Under the lease agreement, the lessee gets the right to
   (a) Share profits earned by the lessor
   (b) Participate in the management of the organisation
   (c) Use the asset for a specified period
   (d) Sell the assets
7. Debentures represent
   (a) Fixed capital of the company
   (b) Permanent capital of the company
   (c) Fluctuating capital of the company
   (d) Loan capital of the company
8. Under the factoring arrangement, the factor
   (a) Produces and distributes the goods or services
   (b) Makes the payment on behalf of the client
   (c) Collects the client's debt or account receivables
   (d) Transfer the goods from one place to another
9. The maturity period of a commercial paper usually ranges from
   (a) 20 to 40 days
   (b) 60 to 90 days
   (c) 120 to 365 days
   (d) 90 to 364 days
10. 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

Short Answer Questions

1. What is business finance? Why do businesses need funds? Explain.
2. List sources of raising long-term and short-term finance.
3. What is the difference between internal and external sources of raising funds? Explain.
4. What preferential rights are enjoyed by preference shareholders. Explain.
5. Name any three special financial institutions and state their objectives.
6. What is the difference between GDR and ADR? Explain.

Long Answer Questions

1. Explain trade credit and bank credit as sources of short-term finance for business enterprises.
2. Discuss the sources from which a large industrial enterprise can raise capital for financing modernisation and expansion.
3. What advantages does issue of debentures provide over the issue of equity shares?
4. State the merits and demerits of public deposits and retained earnings as methods of business finance.
5. Discuss the financial instruments used in international financing.
6. What is a commercial paper? What are its advantages and limitations.

Projects/Assignment

1. Collect information about the companies that have issued debentures in recent years. Give suggestions to make debentures more popular.
2. Institutional financing has gained importance in recent years. In a scrapbook paste detailed information about various financial institutions that provide financial assistance to Indian companies.
3. On the basis of the sources discussed in the chapter, suggest suitable options to solve the financial problem of the restaurant owner.
4. Prepare a comparative chart of all the sources of finance.

CHAPTER 9

SMALL BUSINESS

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- explain the meaning and nature of small business;
- appreciate the role of small business in India;
- analyse the problems of small business; and
- classify the different forms of assistance provided by the government to small business, particularly in rural and hilly areas.

Amar, Akbar and Anthony are three good friends who have completed a vocational course in entrepreneurship, after their school education. Finding the job market tough, they were contemplating the idea of setting up a small business, using the skills they had learnt in their course. However, they knew very little about business. They were wondering what business to start, where to locate it, how to procure machinery and materials needed for the business, how to raise money and how to market. They came across a notification given by the District Industries Centre located near the Industrial Estate in Balanagar, Ranga Reddy district of Andhra Pradesh regarding a seminar on government's assistance for a small business, aimed at young entrepreneurs. Excited with the news, the three friends decided to attend the seminar. They were told about the financial and other assistance offered by the Central and State Governments under the Rural Employment Generation Programme to the educated youth. They found that toys were in demand and decided to manufacture toys. They started a small scale industry in their village by taking financial assistance with the help of Khadi and Village Industries Commission. Today, they are successful makers of toys and in the near future, they plan to get into export market as well.

9.1 Introduction

In the pervious chapters, the concepts of business, trade, commerce and industry were discussed. The present chapter discusses the issue of size of business, with reference to small industries and small business establishments. It also describes the role of small business and the major problems faced by the small sector units. Further, the assistance provided by the government to small business, particularly in the rural and hilly areas has been discussed.

9.2 Meaning and Nature of Small Business

In India, the 'village and small industries sector' consists of both 'traditional' and 'modern' small industries. This sector has eight subgroups. They are handlooms, handicrafts, coir, sericulture, khadi and village industries, small scale industries and powerlooms. The last two come under the modern small industries, while the others come under traditional industries. Village and small industries together provide the largest employment opportunities in India.

Before understanding the nature and meaning of small business, it is important to know how size is defined in our country, with reference to small industries and small business establishments. Several parameters can be used to measure the size of business units. These include the number of persons employed in business, capital invested in business, volume of output or value of output of business and power consumed for business activities. However, there is no parameter which is without limitations. Depending on the need the measures can vary.

The definition used by the Government of India to describe small industries is based on the investment in plant and machinery. This measure seeks to keep in view the socio-economic environment in India where capital is scarce and labour is abundant.

The emergence of a large services sector has necessitated the government to include other enterprises covering both Small Scale Industries (SSI) sector and related service entities under the same umbrella. Expansion of the small scale enterprises was taking place growing into medium scale enterprises and they were required to adopt higher levels of technologies in order to remain competitive in a fast globalising world. Thus, it was necessary to address the concerns of such enterprises micro, small and medium and provide them with a single legal framework. The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 addresses these issues relating to definition, credit, marketing and technology upgradation. Medium scale enterprises and service related enterprises also come under the purview of this Act. The MSMED Act, 2006 came into force w.e.f., October, 2006. Accordingly, enterprises are classified into two major categories viz., manufacturing and services.

Manufacturing

In the case of enterprises engaged in the manufacture or production of goods pertaining to any industries specified in the first schedule to the Industries (Development and Regulation) Act, 1951, there are three types of enterprises:

(i) Micro enterprise, where the investment in plant and machinery does not exceed twenty-five lakh rupees.

(ii) Small enterprise, where the investment in plant and machinery is more than twenty five lakh rupees but does not exceed five crore rupees.

(iii) Medium enterprise, where the investment in plant and machinery is more then five crore rupees but does not exceed ten crores rupees.

Services

In the case of enterprises engaged in providing or rendering of services there are three types of enterprises:

(i) Micro enterprise, where the investment in equipment does not exceed ten lakh rupees.

(ii) Small enterprise, where the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees.

(iii) Medium enterprise, where the investment in equipment is more than two crore rupees but does not exceed five crore rupees.

Village industries: Village industry has been defined as any industry located in a rural area which produces any goods, renders any service with or without the use of power and in which the fixed capital investment per head or artisan or worker is specified by the central government, from time to time.

Cottage industries: These are also known as Rural Industries or Traditional Industries. They are not defined by capital investment criteria as in the case of other small scale industries. However, cottage industries are characterised by certain features like the following:

- these are organised by individuals, with private resources;
- normally use family labour and locally available talent;
- the equipment used is simple;
- capital investment is small;
- produce simple products, normally in their own premises;
- production of goods using indigenous technology.

9.3 Administrative setup for the Small Scale, Agro and Rural Industries

The Government of India created the Ministry of Micro, Small and Medium Enterprises as the nodal ministry for formulation of policy and coordination of central assistance for the promotion and development of small scale industries in India. The Small Industries Development Organisation (SIDO), also known as the Office of the Development Commissioner (SSI) which is attached to this ministry is responsible for implementing and monitoring of various policies and programmes formulated. The Ministry of Micro, Small and Medium Enterprises designs policies, programmes and schemes for promotion and growth of SSIs. The National Small Industries Corporation (NSIC), a public sector enterprise of the Ministry, has been providing marketing support to the medium and small enterprises under the Marketing Assistance Scheme.

Ministry of Agro and Rural Industries is the nodal agency for coordination and development of Village and Khadi industries, tiny and micro enterprises in both urban and rural areas. It also implements Prime Minister's Rojgar Yojana. The various policies, programmes and schemes related to agro and rural industries are implemented by the ministry through the Khadi and Village Industries Commission (KVIC), Handicrafts Board, Coir Board, Silk Board, etc. The KVIC may include the micro or tiny enterprises or the village enterprises as part of small enterprises depending upon the criteria or standards in respect of employment or turnover of the enterprise.

State Governments also execute different promotional and developmental projects and schemes to provide number of supporting incentives for development and promotion of SSIs in

Category	Manufacturing* Investment Limit	Providing of Services Investment Limit
Micro enterprise	25 lakh	10 lakh
Small enterprise	Between 25 lakh and 5 crore	Between 10 lakh and 2 crore
Medium enterprise	Between 5 crore and 10 crore	Between 2 crore and 5 crore

* While calculating the investment in plant and machinery, the cost of pollution control, research and development, industrial safety devices and such other items shall be excluded.

their respective states. These are executed through the State Directorate of Industries, who has District Industries Centres (DICs) under it to implement central/state level schemes.

9.4 Role of Small Business in India

Small Scale Industries in India enjoy a distinct position in view of their contribution to the socio-economic development of the country. The following points highlight their contribution.

(i) Small industries in India account for 95 per cent of the industrial units in the country. They contribute almost 40 per cent of the gross industrial value added and 45 per cent of the total exports (direct and indirect exports) from India.

(ii) Small industries are the second largest employers of human resources, after agriculture. They generate more number of employment opportunities per unit of capital invested compared to large industries. They are, therefore, considered to be more labour intensive and less capital intensive. This is a boon for a labour surplus country like India.

(iii) Small industries in our country supply an enormous variety of products which include mass consumption goods, readymade garments, hosiery goods, stationery items, soaps and detergents, domestic utensils, leather, plastic and rubber goods, processed foods and vegetables, wood and steel furniture, paints, varnishes, safety matches, etc. Among the sophisticated items manufactured are electric and electronic goods like televisions, calculators, electro-medical equipment, electronic teaching aids like overhead projectors, air conditioning equipment, drugs and pharmaceuticals, agricultural tools and equipment and several other engineering products. A special mention should be made of handlooms, handicrafts and other products from traditional village industries in view of their export value. (see Box A which highlights the major industry groups that come under the

Box A

Major Industry Groups in the Small Scale Sector

- Food Products
- Chemical and Chemical Products
- Basic Metal Industries
- Metal Products
- Electrical Machinery and Parts
- Rubber and Plastic Products
- Machinery and Parts except Electrical Goods
- Hosiery and Garments — Wool Products
- Non-metallic Mineral Products
- Paper Products and Printing
- Transport Equipment and Parts
- Leather and Leather Products
- Miscellaneous Manufacturing Industries
- Beverages, Tobacco and Tobacco Products
- Repair Services
- Cotton Textiles
- Wool, Silk, Synthetic Fibre and Textiles
- Jute, Hemp and Mesta Textiles
- Other Services

purview of small industries as per the classification laid down by the government.)

(iv) The contribution of small industries to the balanced regional development of our country is noteworthy. Small industries which produce simple products using simple technologies and depend on locally available resources both material and labour can be set up anywhere in the country. Since they can be widely spread without any locational constraints, the benefits of industrialisation can be reaped by every region. They, thus, contribute significantly to the balanced development of the country.

(v) Small industries provide ample opportunity for entrepreneurship. The latent skills and talents of people can be channelled into business ideas which can be converted into reality with little capital investment and almost nil formalities to start a small business. Amar, Akbar and Anthony in our story proved that a small business can be started, if one has the determination to achieve.

(vi) Small industries also enjoy the advantage of low cost of production. Locally available resources are less expensive. Establishment and running costs of small industries are on the lower side because of low overhead expenses. Infact, the low cost of production which small industries enjoy is their competitive strength.

(vii) Due to the small size of the organisations, quick and timely decisions can be taken without consulting many people as it happens in large sized organisations. New business opportunities can be captured at the right time.

(viii) Small industries are best suited for customised production. i.e. designing the product as per the tastes/ preferences/needs of individual customers, say for an example tailor-made shirt or trouser. The recent trend in the market is to go in for customised production of even non-traditional products such as computers and other such products. They can produce according to the needs of the customers as they use simple and flexible production techniques.

(ix) Last but not the least, small industries have inherent strength of adaptability and a personal touch and therefore maintain good personal relations with both customers and employees. The government does not have to interfere in the functioning of a small scale unit. Due to the small size of the organisation quick and timely decision can be taken without consulting many people as in large sized organisations. New business opportunities can be captured at the right time, thus providing healthy competition to big business which is good for the economy.

9.5 Role of Small Business in Rural India

Traditionally, rural households in developing countries have been viewed as exclusively engaged in agriculture. There is an increasing evidence that rural households can have highly varied and multiple sources of income and that, rural households can and do participate in a wide range of non-agricultural activities such as wage employment and self-employment in commerce, manufacturing and services, along with the traditional rural activities of farming and agricultural labour. This can be largely attributed to the policy initiatives taken by the Government of India, to encourage and promote the setting up of agro-based rural industries.

The emphasis on village and small scale industries has always been an integral part of India's industrial strategy, more so, after the second Five Year Plan. Cottage and rural industries play an important role in providing employment opportunities in the rural areas, especially for the traditional artisans and the weaker sections of society. Development of rural and village industries can also prevent migration of rural population to urban areas in search of employment.

Village and small industries are significant as producers of consumer goods and absorbers of surplus labour, thereby addressing the problems of poverty and unemployment. These industries contribute amply to other socio-economic aspects, such as reduction in income inequalities, dispersed development of industries and linkage with other sectors of the economy.

In fact promotion of small scale industries and rural industrialisation has been considered by the Government of India as a powerful instrument for realising the twin objectives of 'accelerated industrial growth and creating additional productive employment potential in rural and backward areas.'

However, the potential of small industries is often not realised fully, because of several problems related to size. We shall now examine some of the major problems that small businesses whether in urban or in rural areas are encountering in their day-to-day functioning.

9.6 Problems of Small Business

Small scale industries are at a distinct disadvantage as compared to large scale industries. The scale of operations, availability of finance, ability to use modern technology, procurement of raw materials are some of these areas. This gives rise to several problems.

Most of these problems can be attributed to the small size of their business, which prevents them from taking advantages, which accrue to large business organisations. However, the problems faced are not similar to all the categories of small businesses. For instance, in the case of small ancillary units, the major problems include delayed payments, uncertainty of getting orders from the parent units and frequent changes in production processes. The problems of traditional small scale units include remote location with less developed infrastructural facilities, lack of managerial talent, poor quality, traditional technology and inadequate availability of finance.

The problems of exporting small scale units include lack of adequate data on foreign markets, lack of market intelligence, exchange rate fluctuations, quality standards, and pre-shipment finance. In general the small businesses are faced with the following problems:

(i) Finance: One of the severe problems faced by SSIs is that of non-availability of adequate finance to carry out its operations.

Generally a small business begins with a small capital base. Many of the units in the small sector lack the credit worthiness required to raise as capital from the capital markets. As a result, they heavily depend on local financial resources and are frequently the victims of exploitation by the money lenders. These units frequently suffer from lack of adequate working capital, either due to delayed payment of dues to them or locking up of their capital in unsold stocks. Banks also do not lend money without adequate collateral security or guarantees and margin money, which many of them are not in a position to provide.

(ii) Raw materials: Another major problem of small business is the procurement of raw materials. If the required materials are not available, they have to compromise on the quality or have to pay a high price to get good quality materials. Their bargaining power is relatively low due to the small quantity of purchases made by them. Also, they cannot afford to take the risk of buying in bulk as they have no facilities to store the materials. Because of general scarcity of metals, chemicals and extractive raw materials in the economy, the small scale sector suffers the most. This also means a waste of production capacity for the economy and loss of further units.

(iii) Managerial skills: Small business is generally promoted and operated by a single person, who may not possess all the managerial skills required to run the business. Many of the small business entrepreneurs possess sound technical knowledge but are less successful in marketing the output. Moreover, they may not find enough time to take care of all functional activities. At the same time they are not in a position to afford professional managers.

(iv) Labour: Small business firms cannot afford to pay higher salaries to the employees, which affects employee willingness to work hard and produce more. Thus, productivity per employee is relatively low and employee turn over is generally high. Because of lower remuneration offered, attracting talented people is a major problem in small business organisations. Unskilled workers join for low remuneration but training them is a time consuming process. Also, unlike large organisations, division of labour cannot be practised, which results in lack of specialisation and concentration.

(v) Marketing: Marketing is one of the most important activities as it generates revenue. Effective marketing of goods requires a thorough understanding of the customer's needs and requirements. In most cases, marketing is a weaker area of small organisations. These organisations have, therefore, to depend excessively on middlemen, who at times exploit them by paying low price and delayed payments. Further, direct marketing may not be feasible for small business firms as they lack the necessary infrastructure.

(vi) Quality: Many small business organisations do not adhere to desired standards of quality. Instead they concentrate on cutting the cost and keeping the prices low. They do not have adequate resources to invest in quality research and maintain the standards of the industry, nor do they have the expertise to upgrade technology. In fact maintaining quality is their weakest point, when competing in global markets.

(vii) Capacity utilisation: Due to lack of marketing skills or lack of demand, many small business firms have to operate below full capacity due to which their operating costs tend to increase. Gradually this leads to sickness and closure of the business.

(viii) Technology: Use of outdated technology is often stated as serious lacunae in the case of small industries, resulting in low productivity and uneconomical production.

(ix) Sickness: Prevalence of sickness in small industries has become a point of worry to both the policy makers and the entrepreneurs. The causes of sickness are both internal and external. Internal problems include lack of skilled and trained labour and managerial and marketing skills. Some of the external problems include delayed payment, shortage of working capital, inadequate loans and lack of demand for their products.

(x) Global competition: Apart from the problems stated above small businesses are not without fears, especially in the present context of liberalisation, privatisation and globalisation (LPG) policies being followed by several countries across the world. Remember, India too has taken the LPG path since 1991. Let us look into the areas where small businesses feel threatened with the onslaught of global competition.

(a) Competition is not only from medium and large industries, but also from multinational companies which are giants in terms of their size and business volumes. Opening up of trade results in cut throat competition for small scale units.

(b) It is difficult to withstand the quality standards, technological skills, financial creditworthiness, managerial and marketing capabilities of the large industries and multinationals.

(c) There is limited access to markets of developed countries due to the stringent requirements of quality certification like ISO 9000.

9.7 Government Assistance to Small Industries and Small Business Units

Keeping in view the contribution of small business to employment generation, balanced regional development of the country, and promotion of exports, the Government of India's policy thrust has been on establishing, promoting and developing the small business sector, particularly the rural industries and the cottage and village industries in backward areas. Governments both at the central and state level have been actively participating in promoting self-employment opportunities in rural areas by providing assistance in respect of infrastructure, finance, technology, training, raw-materials, and marketing. The various policies and schemes of Government assistance for the development of rural industries insist on the utilisation of local resources and raw materials and locally available manpower. These are translated into action through various agencies, departments, corporations, etc., all coming under the purview of the industries department. All these are primarily concerned with the promotion of small and rural industries.

Some of the support measures and programmes meant for the promotion of small and rural industries are discussed below:

A. Institutional Support

1. National Bank for Agriculture and Rural Development (NABARD)

NABARD was setup in 1982 to promote integrated rural development. Since then, it has been adopting a multi-pronged, multi-purpose strategy for the promotion of rural business enterprises in the country. Apart from agriculture, it supports small industries, cottage and village industries, and rural artisans using credit and non-credit approaches. It offers counselling and consultancy services and organises training and development programmes for rural entrepreneurs.

2. The Rural Small Business Development Centre (RSBDC)

It is the first of its kind set up by the world association for small and medium enterprises and is sponsored by NABARD. It works for the benefit of socially and economically disadvantaged individuals and groups. It aims at providing management and technical support to current and prospective micro and small entrepreneurs in rural areas. Since its inception, RSBDC has organised several programmes on rural entrepreneurship, skill upgradation workshops, mobile clinics and trainers training programmes, awareness and counselling camps in various villages of Noida, Greater Noida and Ghaziabad. Through these programmes it covers a large number of rural unemployed youth and women in several trades, which includes food processing, soft toys making, ready-made garments, candle making, incense stick making, two-wheeler repairing and servicing, vermicomposting, and non conventional building materials.

3. National Small Industries Corporation (NSIC)

This was set up in1955 with a view to promote, aid and foster the growth of small business units in the country. This focuses on the commercial aspects of these functions.

- Supply indigenous and imported machines on easy hire-purchase terms.
- Procure, supply and distribute indigenous and imported raw materials.
- Export the products of small business units and develop export-worthiness.
- Mentoring and advisory services.

- Serve as technology business incubators.
- Creating awareness on techno-logical upgradation.
- Developing software technology parks and technology transfer centres.

A new scheme of **'performance and credit rating'** of small businesses is implemented through National Small Industries Corporation (NSIC) with the twin objectives of (i) sensitising the small industries about the need for credit rating and (ii) encouraging the small business units to maintain good financial track record. This is to ensure that they score higher rating for their credit requirements as and when they approach the financial institutions for their working capital and investment requirements.

Marketing Assistance Scheme

Marketing, a strategic tool for business development, is critical for the growth and survival of micro, small and medium enterprises.

Ministry of Micro, Small and Medium Enterprises, through National Small Industries Corporation (NSIC), a Public Sector Enterprise of the Ministry, has been providing marketing support to Micro and Small Enterprises (MSEs) under the Marketing Assistance Scheme.

Objectives

The broad objectives of the scheme are:

(i) To enhance marketing capabilities and competitiveness of the MSMEs.
(ii) To showcase the competencies of MSMEs.
(iii) To update MSMEs about the prevalent market scenario and its impact on their activities.
(iv) To facilitate the formation of consortia of MSMEs for marketing of their products and services.
(v) To provide platform to MSMEs for interaction with large institutional buyers.
(vi) To disseminate/propagate various programmes of the Government.
(vii) To enrich the marketing skills of the micro, small and medium entrepreneurs.

Marketing Support to MSMEs

Under the Scheme, it is proposed to enhance competitiveness and marketability of their products, through following activities:

(i) Organising International Technology Exhibitions in Foreign Countries by NSIC and Participation in International Exhibitions/Trade Fairs: International Technology Expositions/ exhibitions may be organised by NSIC with a view to providing broader exposure to Indian micro, small and medium enterprises to facilitate them in exploring new business opportunities in emerging and developing markets.

This helps in promoting trade, establishing joint ventures, technology transfers, marketing arrangements and image building of Indian MSMEs in foreign countries. In addition to the organisation of the international exhibitions, NSIC would also facilitate participation of Indian MSMEs in the select international exhibitions and trade fairs. Participation in such events exposes MSMEs to international practices.

(ii) Organising Domestic Exhibitions and Participation in Exhibitions/Trade Fairs in India: Certain theme based exhibitions/ technology fairs etc., may be organised by NSIC, focused on products and services offered by MSMEs, including technologies suitable for employment generation, products from specific regions or clusters (like North Eastern Region, food processing, Machine-tools, Electronics, Leather etc.).

Participation in such events is expected to help the MSMEs in enhancing their marketing avenues by way of capturing new markets and expanding existing markets.

(iii) Support for Co-sponsoring of Exhibitions Organised by other Organisations/Industry Associations/Agencies: This support would be in the form of co-sponsoring of the event by NSIC. In order to apply for co-sponsoring of an event by NSIC, the applicant organisation/agency must fulfill the centre criteria/ conditions.

(iv) Buyer-Seller Meets: Bulk and departmental buyers such as the Railways, Defense, communication departments and large companies are invited to participate in buyer-seller meets to bring them closer to the MSMEs for enhancing their marketing competitiveness. Participation in these programmes enables MSMEs to know the requirements of bulk buyers on the one hand and help the bulk buyers to know the capabilities of MSMEs for their purchases.

(v) Intensive Campaigns and Marketing Promotion Events: To disseminate information about the various schemes for the benefit of the micro, small and medium enterprises. They are also facilitated to enrich their knowledge regarding latest developments, quality standards etc. and improve the marketing potential of their products and services.

(vi) Other Support Activities

- Development of Display Centres, show windows and hoarding etc., for promoting products and services of MSMEs.
- Printing of Literature, Brochures and Product-specific catalogues and CDs etc., and preparation of short films for disseminating information.
- Development of website/portal for facilitating the marketing of MSME products and services.
- Development and dissemination of Advertising and Publicity material about various programes/schemes for MSME sectors and events.
- Preparation and Upgradation of MSME Manufacturers/ Suppliers/ Exporters Directory.
- Documentation of the success stories of MSMEs.
- Conducting studies to explore and assess new markets/ businesses and product ranges for both domestic and international markets.
- Hosting international delegations and networking events.

4. Small Industries Development Bank of India (SIDBI)

- Set up as an apex bank to provide direct/indirect financial assistance

under different schemes, to meet credit needs of small business organisations.
- To coordinate the functions of other institutions in similar activities.

Thus, so far, we have learnt about the various institutions operating at the central level and state level in support of the small industries.

5. The National Commission for Enterprises in the Unorganised Sector (NCEUS)

The NCEUS was constituted in September 2004, with the following objectives:
- To recommend measures considered necessary for improving the productivity of small enterprises in the informal sector.
- To generate more employment opportunities on a sustainable basis, particularly in the rural areas.
- To enhance the competitiveness of the sector in the emerging global environment.
- To develop linkages of the sector with other institutions in the areas of credit, raw materials, infrastructure, technology upgradation, marketing and formulation of suitable arrangements for skill development.

The commission has identified the following issues for detailed consideration:
- Growth poles for the informal sector in the form of clusters/hubs, in order to get external economic aid.
- Potential for public-private partnerships in imparting the skills required by the informal sector.
- Provision of micro-finance and related services to the informal sector.
- Providing social security for the workers in the informal sector.

6. Rural and Women Entrepreneurship Development (RWED)

The Rural and Women Entrepreneurship Development programme aims at promoting a conducive business environment and at building institutional and human capacities that will encourage and support the entrepreneurial initiatives of rural people and women. RWE provides the following services:
- Creating a business environment that encourages initiatives of rural and women entrepreneurs.
- Enhancing the human and institutional capacities required to foster entrepreneurial dynamism and enhance productivity.
- Providing training manuals for women entrepreneurs and training them.
- Rendering any other advisory services.

7. World Association for Small and Medium Enterprises (WASME)

It is the only International Non-Governmental Organisation of micro, small and medium enterprises based in India, which set up an International Committee for Rural Industrialisation. Its aim is to develop an action plan model for sustained growth of rural enterprises.

Apart from these, there are several schemes to promote the non-farm sector, mostly initiated by the Government of India. For instance, there are schemes for entrepreneurship through subsidised loans like Integrated Rural Development Programme (IRDP), Prime Minister Rojgar Yojana (PMRY), schemes to provide skills like Training of Rural Youth for Self Employment (TRYSEM), and schemes to strengthen the gender component like Development of Women and Children in Rural Areas (DWCRA). There are schemes to provide wage employment, like Jawahar Rojgar Yojana (JRY), food for work, etc., on rural works programmes to achieve the twin objectives of creation of rural infrastructure and generation of additional income for the rural poor, particularly during the lean agricultural season. Last, but not the least, there are schemes for specific groups of industries such as khadi, handlooms and handicrafts.

8. Scheme of Fund for Regeneration of Traditional Industries (SFURTI)

To make the traditional industries more productive and competitive and to facilitate their sustainable development, the Central Government set up this fund with Rs. 100 crore allocation to begin within the year 2005. This has to be implemented by the Ministry of Agro and Rural Industries in collaboration with State governments. The main objectives of the scheme are as follows:

- To develop clusters of traditional industries in various parts of the country;
- To build innovative and traditional skills, improve technologies and encourage public-private partnerships, develop market intelligence etc., to make them competitive, profitable and sustainable; and
- To create sustained employment opportunities in traditional industries.

9. The District Industries Centers (DICs)

The District Industries Centers Programme was launched on 1 May 1978, with a view to providing an integrated administrative framework at the district level, which would look at the problems of industrialisation in the district, in a composite manner. In other words, District Industries Centers is the institution at the district level which provides all the services and support facilities to the entrepreneurs for setting up small and village industries. Identification of suitable schemes, preparation of feasibility reports, arranging for credit, machinery and equipment, provision of raw materials and other extension services are the main activities undertaken by these centers. Broadly DICs are trying to bring change in the attitude of the rural entrepreneurs and all other connected with economic development in the rural areas. Even within the narrow spectrum, an attempt is being made to look at some of the neglected factors such as the rural artisan, the skilled craftsman and the handloom operator and to tune up these activities with the general process of rural development being taken up through other national programmes. The DIC is thus emerging as the focal point for economic and industrial growth at the district level.

B. Incentives

Special emphasis on the industrial development of backward, tribal and hilly areas has been the concern of the Government of India expressed in all the Five Year Plans and industrial policy statements. Realising that backward areas development is a long-term process, several committees were appointed to identify the criteria for identifying backward areas and also to suggest schemes to take up the Herculean task of balanced regional development. The implementation of integrated rural development programme is one such attempt made by the government to develop backward areas. The rural industries project programme initiated by the Government of India was meant to develop small business units in select rural areas. Though the backward area development programmes varied from state to state, they cumulatively represented a significant package of incentives to attract industries in backward areas.

Some of the common incentives offered are discussed as below:

Land: Every state offers developed plots for setting up of industries. The terms and conditions may vary. Some states don't charge rent in the initial years, while some allow payment in instalments.

Power: Power is supplied at a concessional rate of 50 per cent, while some states exempt such units from payment in the initial years.

Water: Water is supplied on a no-profit, no-loss basis or with 50 per cent concession or exemption from water charges for a period of 5 years.

Sales Tax: In all union territories, industries are exempted from sales tax, while some states extend exemption for 5 years period.

Octroi: Most states have abolished octroi.

Raw materials: Units located in backward areas get preferential treatment in the matter of allotment of scarce raw materials like cement, iron and steel etc.

Finance: Subsidy of 10-15 per cent is given for building capital assets. Loans are also offered at concessional rates.

Forms of Support Offered to Small Industries by the Government

- Institutional support in respect of credit facilities
- Provision of developed sites for construction of sheds
- Provision of training facilities
- Supply of machinery on hire purchase terms
- Assistance for domestic and export marketing
- Technical and financial assistance for technological up-gradation
- Special incentives for setting up of enterprises in backward areas

Industrial estates: Some states encourage setting up of industrial estates in backward areas.

Tax holiday: Exemption from paying taxes for 5 or 10 years is given to industries established in backward, hilly and tribal areas.

To sum up, it may be stated that the small business sector in India is getting the support of government through various institutions in different forms for different purposes. Despite special attention being given to backward areas, it is observed that imbalances in development are still there. There is a need to develop infrastructural facilities in these areas, as no amount of subsidies or concessions can overcome the natural handicaps caused by a lack of such facilities.

9.8 The Future

The present era is the regime of the World Trade Organisation (WTO), in which the rules of trade are subject to frequent changes as per global expectations. As a founder member of WTO, India too has committed itself to the policy framework of WTO. As a result, small business is also moving away from the pre-liberalisation era of protection. With the Indian economy getting integrated with the global economy, it is inevitable for the small businesses to gear up their capabilities to explore, penetrate and develop new markets. They have to steadily reorient themselves to face the challenges posed by increased competition, domestically and internationally too. With their dynamism, flexibility and innovative entrepreneurial spirit, small businesses have to adapt themselves to the fast changing needs of the market driven economy. Government should reorient its assistance to the small business sector by acting as a facilitator and promoter and not as a regulator. New strategies have to be evolved to foster partnership between large and small industries, adopt cluster approach, develop creative marketing, improve technological skills by upgradation, building export competitiveness by identifying the core competencies of the small businesses.

In fact small business sector should view globalisation as an opportunity for its active participation as suppliers of specialised component and parts. If small businesses are to maintain their market share and healthy growth, they have to create a level-playing field for themselves. The long-term competitive position for the small businesses will depend on how well they learn to manage, adopt and improve their competitive strength.

In short the mantra of success for small businesses in this modern era has to be 'think global, act local.'

Key Terms

Small scale industries	Cottage industries	Micro business enterprises
Expert oriented units	Rural industries	Women enterprises
Ancillary	Khadi industries	Tiny industries

SUMMARY

On the basis of the capital invested, small business units can be categorised into various categories, which include Small Scale Industry, Ancilliary Small Industrial Units, Export Oriented Units, Small Scale Industries owned and managed by Women Entrepreneurs, Tiny Industrial Units, Small Scale Services and Business (Industry related) Enterprises, Micro Business Enterprises, Village Industries and Cottage Industries.

Administrative setup: The administrative setup for small scale industry consists of two ministries viz., the Ministry of Small Scale Industries and Ministry of Agricultural and Rural Industry, Government of India, the Ministry of SSIs is the nodal ministry for formulation of policy and coordination of central assistance, for the promotion and development of SSIs in India.

Similarly, the ministry of Agro and Rural Industries is the nodal agency for coordination and development of village and Khadi Industries, Tiny and Micro Enterprises in both urban and rural area. State Governments also execute different promotional development projected schemes to provide a number of supporting incentives for development and promotion of SSIs in their respective states.

Role of small business in India: Small Scale Industries play a very important role in the socio economic development of the country. These industries account for 95 per cent of industrial units, contributing up to 40 per cent of the gross industrial value added and 45 per cent of the total exports. SSIs are the second largest employers of human resources, after agriculture and produce a variety of products for the economy. These units contribute to the balanced regional development of the country by using locally available material and indigenous technology. These provide ample scope for entrepreneurship; enjoy the advantage of low cost of production; quick decision making, and have quick adaptability and are best suited to customised production.

Role of small business in rural India: Small business units provide multiple source of income, in wide range of non-agricultural activities and provide employment opportunities in rural areas, especially for the traditional artisan and weaker sections of the society.

Problems of small industries: Small Industries suffer from various problems including that of (i) Finance, (ii) Non-availability of raw material,

(iii) Managerial skills, (iv) Skilled labour, (v) Marketing of their goods, (vi) Maintaining Quality standards, (vii) Low capacity utilisation, (viii) Use of traditional technology, (ix) Prevalence of sickness, and (x) Facing global competition.

Governmental assistance to small industries: In view of the contribution of small business in various areas including employment generation, balanced regional development, and promotion of export the central and state government have been providing assistance in respect of infrastructure, finance, technology, training etc., to SSI units.

Some of the major institutions providing support include National Bank for Agriculture and Rural Development, Rural Small Business Development Centre, National Small Industries Corporation, Small Industries Development Bank of India (SIDBI)), The National Commission for Enterprises in Unorganised Sector (NCEUS), Rural and Women Entrepreneurship Development (RWE), World Association for Small and Medium Enterprises (WASME), Scheme of Fund for Regeneration of Traditional Industries (SFURM) and the District Industries centre (DIC).

EXERCISES

Short Answer Questions

1. What are the different parameters used to measure the size of business?
2. What is the definition used by Government of India for Small Scale Industries?
3. How would you differentiate between an ancillary unit and a tiny unit?
4. State the features of cottage industries.

Long Answer Questions

1. How do small scale industries contribute to the socio-economic development of india?
2. Describe the role of small business in rural India.
3. Discuss the problems faced by small scale industries.
4. What measures has the government taken to solve the problem of finance and marketing in the small scale sector?
5. What are the incentives provided by the Government for industries in backward and hilly areas?

Projects/Assignments

1. Prepare a questionnaire to find out the actual problems faced by an owner of a small scale unit. Prepare a project report on it.
2. Survey about five small scale units in your vicinity and find out if they have received any assistance by the institutions setup by the Government.

CHAPTER 10

INTERNAL TRADE

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- describe the meaning and types of internal trade;
- specify the services of wholesalers to manufactures and retailers;
- explain the services of retailers;
- classify the types of retailers;
- explain the forms of small scale and large scale retailers; and
- state the role of Chambers of Commerce and industry in the promotion of internal trade.
- officiate the implementation of GST

Have you ever thought if there were no markets, how products of different manufacturers would reach us? We are all aware of our general provisions store round the corner which is selling items of our daily need. But is that enough? When we need to buy items of a specialised nature, we like to look at bigger markets or shops with variety. Our observation tells us that there are different types of shops selling different items or specialised goods and depending on our requirements we purchase from certain shops or markets. In rural areas, we may have noticed people selling their goods on the streets, these goods may range from vegetables to clothes. This is a completely different scene from what we see in the urban areas. In our country, all kinds of markets co-exist in harmony. With the advent of imported goods and multinational corporations, we have shops selling these products too. In big towns and cities, there are many retail shops selling particular branded products only. Another aspect of all this is, how these products reach the shops from the manufacturers? There must be some middlemen doing this job. Are they really useful or do prices increase because of them?

10.1 Introduction

Trade refers to buying and selling of goods and services with the objective of earning profit. Mankind has been engaged in trading, in some form or the other, since early days of civilisation. The importance of trade in modern times has increased as new products are being developed every day and are being made available for consumption throughout the world. No individual or country can claim to be self-sufficient in producing all the goods and services required by it. Thus, each one is engaged in producing what it is best suited to produce and exchanging the excess produce with others.

On the basis of geographical location of buyers and sellers, trade can broadly be classified into two categories (i) Internal trade; and (ii) External trade. Trade which takes place within a country is called internal trade. Trade between two or more countries, on the other hand, is called external trade. The present chapter discusses in detail the meaning and nature of internal trade and explains its different types and the role of chambers of commerce in promoting internal trade.

10.2 Internal Trade

Buying and selling of goods and services within the boundaries of a nation are referred to as internal trade. Whether the products are purchased from a neighbourhood shop in a locality or a central market or a departmental store or a mall or even from any door-to-door salesperson or from an exhibition, all these are examples of internal trade as the goods are purchased from an individual or establishment within a country. No custom duty or import duty is levied on such trade as goods are part of domestic production and are meant for domestic consumption. Generally, payment has to be made in the legal tender of the country or any other acceptable currency.

Internal trade can be classified into two broad categories viz., (i) wholesale trade and (ii) retail trade. Generally, for products, which are to be distributed to a large number of buyers who are located over a wide geographical area, it becomes very difficult for the producers to reach all the consumers or users directly. For example, if vegetable oil or bathing soap or salt produced in a factory in any part of the country are to reach millions of consumers throughout the country, the help of wholesalers and retailers becomes very important. Purchase and sale of goods and services in large quantities for the purpose of resale or intermediate use is referred to as wholesale trade.

On the other hand, purchase and sale of goods in relatively small quantities, generally to the ultimate consumers, is referred to as retail trade. Traders dealing in wholesale trade are called wholesale traders and those dealing in retail trade are called retailers. Both retailers and wholesalers are important marketing intermediaries who perform very useful functions in the process of exchange of goods and services between producers and users or ultimate consumers. Internal trade aims at equitable distribution of goods within a nation speedily and at reasonable cost.

10.3 Wholesale Trade

As discussed in the previous section, wholesale trade refers to buying and selling of goods and services in large quantities for the purpose of resale or intermediate use.

Wholesaling is concerned with the activities of those persons or establishments which sell to retailers and other merchants, and/or to industrial, institutional and commercial users but who do not sell in significant amount to ultimate consumers. Wholesalers serve as an important link between manufacturers and retailers. They enable the producers not only to reach large number of buyers spread over a wide geographical area (through retailers), but also to perform a variety of functions in the process of distribution of goods and services. They generally take the title of the goods and bear the business risks by purchasing and selling the goods in their own name. They purchase in bulk and sell in small lots to retailers or industrial users. They undertake various activities such as grading of products, packing into smaller lots, storage, transportation, promotion of goods, collection of market information, collection of small and scattered orders of retailers and distribution of supplies to them. They also relieve the retailers of maintaining large stock of articles and extend credit facilities to them. Most of the functions performed by wholesalers are such which cannot be eliminated. If there are no wholesalers, these functions shall have to be performed either by the manufacturers or the retailers.

Services of Wholesalers

Wholesalers provide various services to manufacturers as well as retailers and provide immense help in the distribution of goods and services. By making the products available at a place where these are needed and at a time when these are needed for consumption or use, they provide both the time and place utility. The various services of wholesalers to different sections are discussed below:

10.3.1 Services to Manufacturers

Major services offered by wholesalers to the producers of goods and services are given as below:

(i) Facilitating large scale production: Wholesalers collect small orders from a number of retailers and pass on the pool of such orders to the manufacturers and make purchases in bulk quantities. This enables the producers to undertake production on a large scale and take advantage of the economies of scale.

(ii) Bearing risk: The wholesale merchants deal in goods in their own name, take delivery of the goods and keep the goods purchased in large lots in their warehouses. In the process, they bear variety of risks such as the risk of fall in prices, theft, pilferage, spoilage, fire, etc. To that extent, they relieve the manufacturers from bearing these risks.

(iii) Financial assistance: The wholesalers provide financial assistance to the manufacturers in the sense that they generally make cash payment for the goods purchased by them. To that extent, the manufacturers need not block their capital in the stocks. Sometimes they also advance money to the producers for bulk orders placed by them.

(iv) Expert advice: As the wholesalers are in direct contact with the retailers, they are in a position to advice the manufacturers about various aspects including customer's tastes and preferences, market conditions, competitive activities and the features preferred by the buyers. They serve as an important source of market information on these and related aspects.

(v) Help in marketing function: The wholesalers take care of the distribution of goods to a number of retailers who, in turn, sell these goods to a large number of customers spread over a large geographical area. This relieves the manufacturers from many of the marketing activities and enable them to concentrate on the production activity.

(vi) Facilitate production continuity: The wholesalers facilitate continuity of production activity throughout the year by purchasing the goods as and when these are produced and storing them till the time these are demanded by retailers or consumers in the market.

(vii) Storage: Wholesalers take delivery of goods when these are produced in factory and keep them in their godowns/warehouses. This reduces the burden of manufacturers of providing for storage facilities for the finished products. They thus provide time utility.

10.3.2 Services to Retailers

The important services offered by manufacturers to the retailers are described as below:

(i) Availability of goods: Retailers have to maintain adequate stock of varied commodities so that they can offer variety to their customers. The wholesalers make the products of various manufacturers readily available to the retailers. This relieves the retailers of the work of collecting goods from several producers and keeping big inventory of the same.

(ii) Marketing support: The wholesalers perform various marketing functions and provide support to the retailers. They undertake advertising and other sales promotional activities to induce customers to purchase the goods. The retailers are benefitted as it helps them in increasing the demand for various new products.

(iii) Grant of credit: The wholesalers generally extend credit facilities to their regular customers. This enables the retailers to manage their business with relatively small amount of working capital.

(iv) Specialised knowledge: The wholesalers specialise in one line of products and know the pulse of the market. They pass on the benefit of their specialised knowledge to the retailers. They inform the retailers about the new products, their uses, quality, prices, etc. They may also advise them on the decor of the retail outlet, allocation of shelf space and demonstration of certain products.

(v) Risk sharing: The wholesalers purchase in bulk and sell in relatively small quantities to the retailers. Being able to purchase merchandise in smaller quantities, retailers are in a position to avoid the risk of storage, pilferage, obsolescence, reduction in prices and demand fluctuations in respect of larger quantites of goods that they would have to purchase in case the services of wholesalers are not available.

10.4 Retail Trade

A retailer is a business enterprise that is engaged in the sale of goods and services directly to the ultimate consumers. The retailer normally buys goods in large quantities from the wholesalers and sells them in small quantities to the ultimate consumers. The retails represents the final stage in the distribution where goods are transferred from the hands of the manufacturers or wholesalers to the final consumers or users. Retailing is, thus, that branch of business which is devoted to the sale of goods and services to the ultimate consumers for their personal and non-business use.

There may be different ways of selling the goods viz., personally, on telephone, or through vending machines. Also, the products may be sold at different places, viz., in a store, at the customer's house or any other place. Some of the common situations that we encounter in our daily life, for example, are the sale of ball pens or some magic medicine or book of jokes in the roadways buses; the sale of cosmetics/detergent powder, on door-to-door sales basis; and the sale of vegetables by the road side by a small farmer. But as long as the goods are sold to ultimate consumers, these will be treated as cases of retail selling. Thus, irrespective of 'how' the products are sold or 'where' the sale is made, if the sales are made directly to the consumers, it will be considered as retailing.

A retailer performs different functions in the distribution of goods and services. He/she purchases a variety of products from the wholesale distributors and others, arranges for proper storage of goods, sells the goods in small quantities, bears business risks, grades the products, collects market information, extends credit to the buyers and promotes the sale of products through displays, participation in various schemes, etc.

Services of Retailers

Retailers serve as an important link between the producers and final consumers in the distribution of products and services. They provide useful services to the consumers, wholesalers and manufacturers. Some of the important services of retailers are described as below:

10.4.1 Services to Manufacturers and Wholesalers

The invaluable services that the retailers render to the wholesalers and producers are given as here under:

(i) Help in distribution of goods: A retailer's most important service to the wholesalers and manufacturers is to provide help in the distribution of their products by making these available to the final consumers, who may be scattered over a large geographic area. They thus provide place utility.

(ii) Personal selling: In the process of sale of most consumer goods, some amount of personal selling effort is necessary. By undertaking personal selling efforts, the retailers relieve the producers of this activity and greatly help them in the process of actualising the sale of the products.

(iii) Enabling large-scale operations: On account of retailer's services, the manufacturers and wholesalers are freed from the trouble of making individual sales to consumers in small quantities. This enables them to operate on, at relatively large scale, and thereby fully concentrate on their other activities.

(iv) Collecting market information: As retailers remain in direct and constant touch with the buyers, they serve as an important source of collecting market information about the tastes, preferences and attitudes of customers. Such information is considered very useful in taking important marketing decisions in an organisation.

(v) Help in promotion: From time-to-time, manufacturers and distributors have to carry on various promotional activities in order to increase the sale of their products. For example, they have to advertise their products and offer short-term incentives in the form of coupons, free gifts, sales contests, and so on. Retailers participate in these activities in various ways and, thereby, help in promoting the sale of the products.

10.4.2 Services to Consumers

Some of the important services of retailers from the point of view of consumers are as follows :

(i) Regular availability of products: The most important service of a retailer to consumers is to maintain regular availability of various products produced by different manufacturers. This enables the buyers to buy products as and when needed.

(ii) New products information: By arranging for effective display of products and through their personal selling efforts, retailers provide important information about the arrival, special features, etc., of new products to the customers. This serves as an important factor in the buying decision making process of the purchase of such goods.

(iii) Convenience in buying: Retailers generally buy goods in large quantities and sell these in small quantities, according to the requirements of their customers. Also, they are normally situated very near to the residential areas and remain open for long hours. This offers great convenience to the customers in buying products of their requirements.

(iv) Wide selection: Retailers generally keep stock of a variety of products of different manufacturers. This enables the consumers to make their choice out of a wide selection of goods.

(v) After-sales services: Retailers provide important after-sales services in the form of home delivery, supply of spare parts and attending to customers. This becomes an important factor in the buyers' decision for repeat purchase of the products.

(vi) Provide credit facilities: The retailers sometimes provide credit facilities to their regular buyers. This enables the latter to increase their level of consumption and, thereby, their standard of living.

Terms of Trade

The following are the main terms used in the trade

1. **Cash on delivery (COD):-** It refers to a type of transaction in which payment for goods or services is made at the time of delivery. If the buyer is unable to make payment when the goods or services are delivered then it will be returned to the seller.
2. **Free on Board or Free on Rail (FoB or FOR):-** It rerers to a contract between the seller and the buyer in which all the expenses up to the point of delivery to a carrier (it may be a ship, rail, lorry, etc.) are to be borne by seller.
3. **Cost, Insurance and Freight (CFF):-** It is the price of goods which includes not only the cost of goods but also the insurance and frieght charges payable on goods upto destination port.
4. **Errors and Omissions Excepted(E&OE):-** It refers to that term which is used in trade documents to say that mistakes and things that have been forgotten should be taken into account.

10.5 Types of Retailing Trade

There are many types of retailers in India. For proper understanding, it would be useful, to classify them into certain common categories. Different classifications have been used by experts to categorise retailers into different types. For example, on the basis of 'size of business', they may be categorised into large, medium and small retailers. On the basis of 'type of ownership', they may be categorised into 'sole trader', 'partnership firm', 'cooperative store' and 'company'. Similarly, on the basis of 'merchandise handled', the different classifications may be 'speciality store', 'supermarket' and 'departmental store'. Another common basis of classification is whether or not they have a fixed place of business. On this basis, there are two categories of retailers:

(a) Itinerant retailers, and
(b) Fixed shop retailers

Both these types of retailers have been described in detail in the sections that follow here after.

10.5.1 Itinerant Retailers

Itinerant retailers are traders who do not have a fixed place of business to operate from. They keep on moving with their wares from street to street or place to place, in search of customers.

Characteristics

(a) They are small traders operating with limited resources.
(b) They normally deal in consumer products of daily use such as toiletry products, fruits and vegetables, and so on.
(c) The emphasis of such traders is on providing greater customer service by making the products available at the very doorstep of the customers.
(d) As they do not have any fixed business establishment to operate from, these retailers have to keep their limited inventory of merchandise either at home or at some other place.

Some of the most common types of itinerant retailers operating in India are as below:

(i) Peddlers and hawkers: Peddlers and hawkers are probably amongst the oldest form of retailers in the market place who have not lost their utility even during the modern times. They are small producers or petty traders who carry the products on a bicycle, a hand cart, a cycle-rickshaw or on their heads, and move from place to place to sell their merchandise at the doorstep of the customers. They generally deal in non-standardised and low-value products such as toys, vegetables and fruits, fabrics, carpets, snacks and ice creams, etc. They are also found in streets of residential areas, places of exhibitions or meals, and outside schools, during a lunch break.

The main advantage of this form of retailing is the provision of convenient service to the consumers. However, one should be careful in dealing with them, as the products they deal in are not always reliable in terms of quality and price.

(ii) Market traders: Market traders are the small retailers who open their shops at different places on fixed days or dates, such as every Saturday or alternate Saturdays, and so on. These traders may be dealing in one particular line of merchandise, say fabrics or ready-made garments, toys, or crockery, or alternatively, they may be general merchants. They are mainly catering to lower-income group of customers and deal in low-priced consumer items of daily use.

(iii) Street traders (pavement vendors): Street traders are the small retailers who are commonly found at places where huge floating population gathers, for example, near railway stations and bus stands, and sell consumer items of common use, such as stationery items, eatables, ready-made garments, newspapers and magazines. They are different from market traders in the sense that they do not change their place of business so frequently.

(iv) Cheap jacks: Cheap jacks are petty retailers who have independent shops of a temporary nature in a business locality. They keep on changing their business from one locality to another, depending upon the potentiality of the area. However, the change of place is not as frequent as in the case of hawkers or market traders. They deal in consumer items as well as services such as repair of watches, shoes, buckets etc.

10.5.2 Fixed Shop Retailers

This is the most common type of retailing in the market place. As is evident from the name, these are retail shops who maintain permanent establishment to sell their merchandise. They, therefore, do not move from place to place to serve their customers. Some of the other characteristics of such traders are:

Characteristics

(a) Compared with the itinerant traders, normally they have greater resources and operate on a relatively large scale. However, there are different size groups of fixed shop retailers, varying from very small to very large.
(b) These retailers may be dealing in different products, including consumer durables as well as non-durables.
(c) This category of retailers has greater credibility in the minds of customers, and they are in a position to provide greater services to the customers such as home delivery, guarantees, repairs, credit facilities, availability of spares, etc.

Types

The fixed-shop retailers can be classified into two distinct types on the basis of the size of their operations. These are:

(a) small shop-keepers, and
(b) large retailers.

The different types of retailers falling under the above two broad heads are described as follows:

Fixed Shop Small Retailers

(i) General stores: General stores are most commonly found in a local market and residential areas. As the name indicates, these shops carry stock of a variety of products required to satisfy the day-to-day needs of the consumers residing in nearby localities. Such stores remain open for long hours at convenient timings and often provide credit facilities to some of their regular customers.

The biggest advantage of such stores is in terms of convenience to the customers in buying products of daily use such as grocery items, soft drinks, toiletry products, stationery and confectionery. As most of their customers are residents of the same locality, an important factor contributing to their success is the image of the owner and the rapport he has established with them.

(ii) Speciality shops: This type of retail store is, of late, becoming very popular, particularly in urban areas. Instead of selling a variety of products of different types, these retail stores specialise in the sale of a specific line of products. For example, shops selling children's garments, men's wear, ladies shoes, toys and gifts, school uniforms, college books or consumer electronic goods, etc. These are some of the commonly found stores of this type in the marketplace.

The speciality shops are generally located in a central place where a large number of customers can be attracted, and they provide a wide choice to the customers in the selection of goods.

(iii) Street stall holders: These small vendors are commonly found at street crossings or other places where flow of traffic is heavy. They attract floating customers and deal mainly in goods of cheap variety like hosiery products, toys, cigarettes, soft drinks, etc. They get their supplies from local suppliers as well as wholesalers. The total area covered by a stall is very limited and, therefore, they handle goods on a very small scale. Their main advantage is in providing convenient service to the customers in buying some of the items of their needs.

(iv) Second-hand goods shop: These shops deal in second-hand or used goods, like books, clothes, automobiles, furniture and other household goods. Generally persons with modest means purchase goods from such shops. The goods are sold at lower prices. Such shops may also stock rare objects of historical value and antique items which are sold at rather heavy prices to people who have special interest in such antique goods.

The shops, selling second-hand goods may be located at street crossings or in busy streets in the form of a stall having very little structure — a table or a temporary platform to display the books or may have reasonably good infrastructure, as in the case of those selling furniture or used cars or scooters or motorcycles.

Fixed shop — Large stores

1. **Departmental stores**

   A departmental store is a large establishment offering a wide variety of products, classified into well-defined departments, aimed at satisfying practically every customer's need under one roof. It has a number of departments, each one confining its activities to one kind of product. For example, there may be separate departments for toiletries, medicines, furniture, groceries, electronics, clothing and dress material within a store. Thus, they satisfy diverse market segments with a wide variety of goods and services. It is not uncommon for a department store in the United States of America to carry 'needle to an aeroplane' or 'all shopping under one roof.' Everything from 'a pin to an elephant' is the spirit behind a typical department store. In India real departmental stores have not yet come in a big way in the retailing business. However, some stores on this line in India include 'Akberally' in Mumbai and 'Spencers' in Chennai. Some of the important features of a departmental store are as follows:

(a) A modern departmental store may provide all facilities such as restaurant, travel and information bureau, telephone booth, rest-rooms, etc. As such they try to provide maximum service to higher class of customers for whom price is of secondary importance.

(b) These stores are generally located at a central place in the heart of a city, which caters to a large number of customers.

(c) As the size of these stores is very large, they are generally formed as a joint stock company managed by a board of directors. There is a managing director assisted by a general manager and several department managers.

(d) A departmental store combines both the functions of retailing as well as warehousing. They purchase directly from manufacturers and operate separate warehouses. That way they help in eliminating undesirable middlemen between the producers and the customers.

(e) They have centralised purchasing arrangements. All the purchases in a department store are made centrally by the purchase department of the store, whereas sales are decentralised in different departments.

Advantages

The major advantages of retailing through departmental stores may be listed as follows:

(i) Attract large number of customers: As these stores are usually located at central places, they attract a large number of customers during the best part of the day.

(ii) Convenience in buying: By offering large variety of goods under one roof, the departmental stores provide great convenience to customers in buying almost all goods of their requirements at one place. As a result, customers do not have to run from one place to another to complete their shopping.

(iii) Attractive services: A departmental store aims at providing maximum services to the customers. Some of the services offered by it include home delivery of goods, execution of telephone orders, grant of credit facilities and provision for restrooms, telephone booths, restaurants, saloons, etc.

(iv) Economy of large-scale operations: As these stores are organised at a very large scale, the benefits of large scale operations, particularly, in respect of purchase of goods are available to them.

(v) Promotion of sales: The departmental stores are in a position to spend considerable amount of money on advertising and other promotional activities, which help in boosting their sales.

Limitations

However, there are certain limitations of this type of retailing. These are described as follows:

(i) Lack of personal attention: Because of the large-scale operations, it is very difficult to provide adequate personal attention to the customers in these stores.

(ii) High operating cost: As these stores give more emphasis on providing services, their operating costs tend to be on the higher side. These costs, in turn, make the prices of the goods high. They are, therefore, not attractive to the lower income group of people.

(iii) High possibility of loss: As a result of high operating costs and large-scale operations, the chances of incurring losses in a departmental store are high. For example, if there is any change in the tastes of customers or latest fashions, it necessitates selling of such out-of-fashion articles in clearance sale, to reduce the huge inventory of goods built up.

(iv) Inconvenient location: As a departmental store is generally situated at a central location, it is not convenient for the purchase of goods that are needed at short notice.

In spite of some of these limitations the departmental stores have been popular in some of the western countries of the world because of their benefits to a certain class of customers.

2. **Chain Stores or Multiple Shops:** Chain stores or multiple shops are networks of retail shops that are owned and operated by manufacturers or intermediaries. Under this type of arrangement, a number of shops with similar appearance are established in localities, spread over different parts of the country. These different shops normally deal in standardised and branded consumer products, which have rapid sales turnover. These shops are run by the same organisation and have identical merchandising strategies, with identical products and displays. Some of the important features of such shops may be described as follows:

(a) These shops are located in fairly populous localities, where sufficient number of customers can be approached. The idea is to serve the customers at a point which is nearest to their residence or work place, rather than attracting them to a central place.

(b) The manufacturing/procurement of merchandise for all the retail units is centralised at the head office, from where the goods are despatched to each of these shops according to their requirements. This results in savings in the cost of operation of these stores.

(c) Each retail shop is under the direct supervision of a Branch Manager, who is held responsible for its day-to-day management. The Branch Manager sends daily reports to the head office in respect of the sales, cash deposits, and the requirements of the stock.

(d) All the branches are controlled by the head office, which is concerned with formulating the policies and getting them implemented.

(e) The prices of goods in such shops are fixed and all sales are made on cash basis. The cash realised from the sales of merchandise is deposited daily into a local bank account on behalf of the head office, and a report is sent to the head office in this regard.

(f) The head office normally appoints inspectors, who are concerned with day-to-day supervision of the shops, in respect of quality of customer service provided, adherence to the policies of the head office, and so on.

The chain operation is most effective in handling high-volume merchandise, whose sales are relatively constant throughout the year. In India, Bata Shoe stores are typical examples of such shops. Similar type of retail outlets are coming up in other products also. For example, the exclusive showrooms of D.C.M., Raymonds and the fast food chains of Nirula's and McDonalds.

Advantages

Multiple shops are offering various advantages to the consumers, which are described as follows:

(i) Economies of scale: As there is central procurement, the multiple-shop organisation enjoys the economies of scale.

(ii) Elimination of middlemen: By selling directly to the consumers, the multiple-shop organisation is able to eliminate unnecessary middlemen in the sale of goods and services.

(iii) No bad debts: Since all the sales in these shops are made on cash basis, there are no losses on account of bad debts.

(iv) Transfer of goods: The goods not in demand in a particular locality may be transferred to another locality where it is in demand. This reduces the chances of dead stock in these shops.

(v) Diffusion of risk: The losses incurred by one shop may be covered by profits in other shops, reducing the total risk of an organisation.

(vi) Low cost: Because of centralised purchasing, elimination of middlemen, centralised promotion of sales and increased sales, the multiple shops have lower cost of business.

(vii) Flexibility: Under this system, if a shop is not operating at a profit, the management may decide to close it or shift it to some other place without really affecting the profitability of the organisation as a whole.

Limitations

(i) Limited selection of goods: Some of the multiple shops deal only in limited range of products. This is especially the problem with the chain stores which are owned and operated by manufacterers, and as such mostly sell the products produced by the themselves. They do not sell products of other manufacturers. In that way the consumers get only a limited choice of goods. This, however is not the case with retailer owned chain stores such as Big Apple or Reliance Retail which sell products of a large number of manufacturers.

(ii) Lack of initiative: The personnel managing the multiple shops have to obey the instructions received from the head office. This makes them habitual of looking up to the head office for guidance on all matters, and takes away the initiative from them to use their creative skills to satisfy the customers.

(iii) Lack of personal touch: Lack of initiative in the employees sometimes leads to indifference and lack of personal touch in them.

(iv) Difficult to change demand: If the demand for the merchandise handled by multiple shops change rapidly, the management may have to sustain huge losses because of large stocks lying unsold at the central depot.

Difference between Departmental stores and Multiple shops

Although both these types of retail organisations are large establishments, there are certain differences between the two. Such differences are given here below:

(i) Location: A departmental store is located at a central place, where a large number of customers can be attracted to it. However, the multiple stores are located at a number of places for approaching a large number of customers. Thus, central location is not necessary for a multiple shop.

(ii) Range of products: Departmental stores aim at satisfying all the needs of customers under one roof. As such, they have to carry a variety of products of different types. However, the multiple stores generally aim to satisfy the requirements of customers relating to a specified range of their products only.

(iii) Services offered: The departmental stores lay great emphasis on providing maximum service to their customers. Some of the services, provided by them include alteration of garments, restaurant and so on. As against this, the multiple shops provide very limited service confined to guarantees and repairs if the sold out goods turn out to be defective.

(iv) Pricing: The multiple shop chains sell goods at fixed prices and maintain uniform pricing policies for all the shops. The departmental stores, however, do not have uniform pricing policy for all the departments; rather they have to occasionally offer discounts on certain products and varieties to clear their stock.

(v) Class of customers: The departmental stores cater to the needs of relatively high income group of customers who care more for the services provided rather than the prices of the product. The multiple shops, on the other hand, cater to different types of customers, including those belonging to the lower income groups, who are interested in buying quality goods at reasonable prices.

(vi) Credit facilities: All sales in the multiple shops are made strictly on cash basis. In contrast, the departmental stores may provide credit facilities to some of their regular customers.

(vii) Flexibility: As the departmental stores deal in a wide variety of products, they have certain flexibility in respect of the line of goods marketed. However, there is not much scope for flexibility in the chain stores, which deal only in limited line of products.

Mail Order Houses

Mail order houses are the retail outlets that sell their merchandise through mail. There is generally no direct personal contact between the buyers and the sellers in this type of trading. For obtaining orders, potential customers are approached through advertisements in newspapers or magazines, circulars, catalogues, samples and bills, and price lists sent to them by post. All the relevant information about the products such as the price, features, delivery terms, terms of payment, etc., are described in the advertisement. On receiving the orders, the items are carefully scrutinised with respect to the specifications asked for by the buyers and are complied with through the post office.

There can be different alternatives for receiving payments. First, the customers may be asked to make full payment in advance. Second, the goods may be sent by Value Payable Post (VPP). Under this arrangement, the goods are sent through post and are delivered to the customers only on making full payment for the same. Third, the goods may be sent through a bank, which is instructed to deliver the articles to the customers. In this arrangement there is no risk of bad debt, as the goods are handed over to the buyers only after he makes full payment. However, there is a need to ensure the buyers that the goods despatched are in accordance with their specifications.

This type of business is not suitable for all types of products. For example, goods that are perishable in nature or are bulky and cannot be easily handled, are not recommended for mail-house trading. Only the goods that can be (i) graded and standardised, (ii) easily transported at low cost, (iii) have ready demand in the market, (iv) are available in large quantity throughout the year, (v) involve least possible competition in the market and (vi) can be described through pictures etc., are suitable for this type of trading. Another important point in this regard is that mail house business cannot be successfully carried out unless education is wide spread. It is so because only the literate people can be reached through advertisements and other forms of written communication.

Advantages

(i) Limited capital requirement: Mail order business does not require heavy expenditure on building and other infrastructural facilities. Therefore, it can be started with relatively low amount of capital.
(ii) Elimination of middle men: The biggest advantage of mail-order business from the point of view of consumers is that unnecessary middlemen between the buyers and sellers are eliminated. This may result in lot of savings both to the buyers as well as to the sellers.
(iii) Absence of bad debt: Since the mail order houses do not extend credit facilities to the customers, there are no chances of any bad debt on account of non payment of cash by the customers.
(iv) Wide reach: Under this system the goods can be sent to all the places having postal services. This opens wide scope for business as a large number of people throughout the country can be served through mail.
(v) Convenience: Under this system goods are delivered at the doorstep of the customers. This results in great convenience to the customers in buying these products.

Limitations

(i) Lack of personal contact: As there is no personal contact between the buyers and the sellers under the system of mail order selling, there are greater possibilities of mis-understanding and mistrust between the two. The buyers are not in a position to examine the products before buying and the sellers cannot pay personal attention to the likes and dislikes of the buyers and cannot clear all their doubts through catalogues and advertisements.
(ii) High promotion cost: The mail order business has to rely heavily on advertisements and other methods of promotion in order to inform and persuade the potential buyers to buy their products. As a result, there is heavy expenditure on promotion of the products.
(iii) No after sales service: In mail order selling, the buyers and sellers may be located very far away from each other and there is no personal contact between the two. As a result, there is absence of after sales services which is so important for the satisfaction of the customers.
(iv) No credit facilities: The mail order houses do not provide credit facilities to the buyers. Thus, customers with limited means may not be interested in this type of trading.
(v) Delayed delivery: There is no immediate delivery of goods to the customers, as receipt and execution of order through mail takes its own time.
(vi) Possibility of abuse: This type of business provides greater possibility of abuse to dishonest traders to cheat the

customers by making false claims about the products or not honouring the commitments made through hand bills or advertisements.

(vii) High dependence on postal services: The success of mail order business depends heavily on the availability of efficient postal services at a place. But in a vast country like ours, where many places are still without postal facilities, this type of business has limited prospects.

Consumer Cooperative Store

A consumer cooperative store is an organisation owned, managed and controlled by consumers themselves. The objective of such stores is to reduce the number of middlemen who increase the cost of produce, and thereby provide service to the members. The cooperative stores generally buy in large quantity, directly from manufacturers or wholesalers and sell them to the consumers at reasonable prices. Since the middleman are eliminated or reduced, the members get products of good quality at cheaper rates. The profits earned by consumer cooperative stores during a year are utilised for declaring bonus to members and for strengthening the general reserves and general welfare funds or similar funds for social and educational benefits of the members.

To start a consumer cooperative store, at least 10 people have to come together and form a voluntary association and get it registered under the Cooperative Societies Act. The capital of a cooperative store is raised by issue of shares to members. The management of the store is democratic and entrusted to an elected managing committee where one man one vote is the rule. The liability of the members of a cooperative store is generally limited to the extent of the capital contributed by them. To ensure fair management of funds, the accounts of the stores are audited by the Registrar of Cooperative Societies or a person authorised by him/her.

Advantages

The major advantages of a consumer cooperative store are as follows:

(i) Ease information: It is easy to form a consumer cooperative society. Any ten people can come together to form a voluntary association and get themselves registered with the Registrar of Cooperative Societies by completing certain formalities.

(ii) Limited liability: The liability of the members in a cooperative store is limited to the extent of the capital contributed by them. Over and above that amount, they are not liable personally to pay for the debts of society, in case the liabilities are greater than its assets.

(iii) Democratic management: Cooperative societies are democratically managed through management committees which are elected by the members. Each member has one vote, irrespective of the number of shares held by him/her.

(iv) Lower prices: A cooperative store purchases goods directly from the manufacturers or wholesalers and sells them to members and others. Elimination of middlemen results in lower prices for the consumer goods to the members.

(v) Cash sales: The consumer cooperative stores normally sell goods on cash basis. As a result, the requirement for working capital is reduced.

(vi) Convenient location: The consumer cooperative stores are generally opened at convenient public places where the members and others can easily buy the products as per their requirements.

Limitations

The limitations of consumer cooperative stores are given as below:

(i) Lack of initiative: As the cooperative stores are managed by people who work on honorary basis, there is a lack of sufficient initiative and motivation amongst them to work more effectively.

(ii) Shortage of funds: The primary source of funds for a cooperative store is the money raised from members by issue of shares. The stores generally face shortage of funds as membership is limited. This comes in the way of growth and expansion of the cooperative stores.

(iii) Lack of patronage: The members of the cooperative stores generally do not patronise them regularly. As a result of this, the stores are not able to operate successfully.

(iv) Lack of business training: The people entrusted with the management of cooperative stores lack expertise as they are not trained in running the stores efficiently.

Super Markets

A super market is a large retailing business unit selling wide variety of consumer goods on the basis of low price appeal, wide variety and assortment, self-service and heavy emphasis on merchandising appeal. The goods traded are generally food products and other low priced, branded and widely used consumer products such as grocery, utensils, clothes, electronic appliances, household goods, and medicines. Super markets are generally situated at the main shopping centres. Goods are kept on racks with clearly labelled price and quality tags in such stores. The customers move into the store to pick up goods of their requirements, bring them to the cash counter, make payment and take home the delivery.

Super markets are organised on departmental basis where customers can buy various types of goods under one roof. However, as compared to departmental stores, these markets do not offer certain services such as free home delivery, credit facilities, etc., and also do not appoint sales persons to convince customers about the quality of products. Some of the important characteristics of a super market are as follows:

(i) A super market generally carries a complete line of food items and groceries, in addition to non-food convenience goods.

(ii) The buyers can purchase different products as per their requirements under one roof in such markets.

(iii) A super market operates on the principle of self-service. The distribution cost is, therefore, lower.

(iv) The prices of the products are generally lower than other types of retail stores because of bulk purchasing, lower operational cost, and low profit margins.

(v) The goods are sold on cash basis only.

(vi) The super markets are generally located at central locations to secure high turnover.

Advantages

The following are the merits of super markets:

(i) One roof, low cost: Super markets offer a wide variety of products at low cost under one roof. These outlets are, therefore, not only convenient but also economical to the buyers for making their purchases.

(ii) Central location: The super markets are generally located in the heart of the city. As a result, these are easily accessible to large number of people staying in the surrounding localities.

(iii) Wide selection: Super markets keep a wide variety of goods of different designs, colour, etc., which enables the buyers to make better selection.

(iv) No bad debts: As generally the sales are made on cash basis, there are no bad debts in super markets.

(v) Benefits of being large scale: A super market is a large scale retailing store. It enjoys all the benefits of large scale buying and selling because of which its operating costs are lower.

Limitations

The major limitations of super markets are as follows:

(i) No credit: Super markets sell their products on cash basis only. No credit facilities are made available to the buyers. This restricts the purchasing power of buyers from such markets.

(ii) No personal attention: Super markets work on the principle of self-service. The customers, therefore, do not get any personal attention. As a result, such commodities that require personal attention by sales people cannot be handled effectively in super markets.

(iii) Mishandling of goods: Some customers handle the goods kept in the shelf carelessly. This may raise costs in super markets.

(iv) High overhead expenses: Super market incur high overhead expenses. As a result these have not been able to create low price appeal among the customers.

(v) Huge capital requirement: Establishing and running a super market requires huge investment. The turnover of a store should be high so that the overheads are kept under reasonable level. This can be possible in bigger towns but not in small towns.

Vending Machines

Vending machines are the newest revolution in marketing methods. Coin operated vending machines are proving useful in selling several products such as hot beverages, platform tickets, milk, soft drinks, chocolates, newspaper, etc., in many countries. Apart from some of the products mentioned here, the latest area in which this concept is getting popular in many parts of our country (particularly in the urban areas) is the case of Automated Teller Machines (ATM) in the banking service. As the name suggests, these machines have altogether changed the concept of banking and made it possible to withdraw money at any time without visiting any branch of a bank.

Vending machines can be useful for selling pre-packed brands of low priced products which have high turnover and which are uniform in size and weight. However, the initial cost of installing a vending machine and the expenditure on regular maintenance and repair are quite high. Also consumers cannot feel or see the product before buying and do not have the opportunity of returning unwanted goods. Apart from that, special packs have to be developed for the machines. The machines have to be made reliable in their operations. In spite of these limitations, with the growth in the economy, vending machines have a promising future in retail sales of high turnover and low priced consumer products.

Goods and Services Tax

The Government of India, following the *credo* of 'One Nation and One Tax', and wanting a unified market in order to ensure the smooth flow of goods across the country implemented the Goods and Services Tax (GST) from July 1, 2017. The move also aims to make life easier for manufacturers, producers, investors and consumers. This system is regared as the most revolutionising tax reform in the Indian taxation history. Tax apart from being a source of revenue for growth also plays a key role in making the State accountable to its taxpayers. Effective taxation ensures that public funds are effectively employed in fulfilling social objectives for sustainable development.

GST is a destination-based single tax on the supply of goods and services from the manufacturer to the consumer, and has replaced multiple indirect taxes levied by the Central and the State governments, thereby, converting the country into a unified market. Among other benefits, GST is expected to improve the ease of doing business in tax compliance, reduce the tax burden by eliminating tax-on-tax, improve tax administration, mitigate tax evasion, broaden the organised segment of the economy and boost tax revenues. The GST has replaced 17 indirect taxes (8 Central + 9 State levels) and 23 cesses of the Centre and the States, eliminating the need for filing multiple returns and assessments and rationalising the tax treatment of goods and services along the supply chain from producers to consumers. GST comprises Central GST (CGST) and the State GST (SGST), subsuming levies previously charged by the Central and the State governments respectively. GST (CGST + SGST) is charged at each stage of value addition and the supplier off-sets the levy on inputs in the previous stages of value chain through the tax credit mechanism. The last dealer in the supply chain passes on the added GST to the consumer, making GST a destination-based consumption tax. The provision of availing input credit at each stage of value chain helps in avoiding the cascading effect (tax on tax) under GST, which is expected to reduce prices of commodities and benefit the consumers. (refer page 253)

Some Facts about GST

1. GST aims to subsume a plethora of taxes into one single tax across the country and make goods uniformly priced across India, albeit some goods become costly and some become cheaper.
2. With the implementation of GST, luxury goods have become costlier, while items of mass consumption have become cheaper.
3. GST is not taxation at source. It is a destination tax or rather it's a consumption tax. A product is manufactured in Tamil Nadu and travels through the country before it reaches Delhi, where the buyer or consumer pays tax for it. Both the Centre and the State have their share in this tax.
4. The Indian GST will have a mechanism of matching of invoices. Input tax credit of purchased goods and services will only be available if the taxable supplies received by the supplies received by the supplier. The Goods and Services Tax network is a self-regulating mechanism, which not only checks tax frauds and tax evasion, but also brings in more and more businesses into the formal economy.
5. Anti-profiteering measure is one of the key features of the recently implemented Goods and Services Tax law. These measures prevent entities from making excessive profits. Since the GST, along with the input tax credit, is eventually expected to bring down prices, a National Anti-profiteering Authority (NAA) is to be set up to ensure that the benefits accrued to entities due to reduction in costs is passed on to the consumers. Also, entities that hike rates inordinately, citing GST as the reason, will be checked by this body.

How will GST Benefit and Empower Citizens

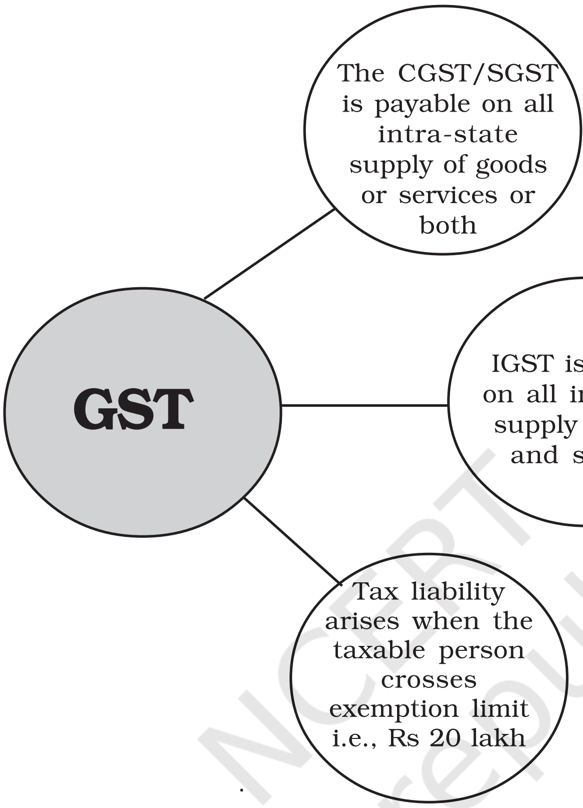
- Reduction in overall tax burden
- No hidden taxes
- Development of a harmonised national market for goods and services
- Higher disposable income in hand, education and essential needs
- Customers to have wider choice
- Increased economic activity
- More employment opportunities

Key Features of GST:

1. The territorial spread of GST is the whole country, including Jammu and Kashmir.
2. GST is applicable on the 'supply' of goods or services as against the present concept of tax on the manufacture or sale of goods or on the provision of services.
3. It is based on the principle of destination-based consumption tax against the present principle of origin-based taxation.
4. Import of goods and services is treated as inter-State supplies and would be subject to IGST in addition to the applicable customs duties.
5. CGST, SGST and IGST are levied at rates mutually agreed upon by the Centre and the States under the aegis of the GST Council.
6. There are four tax slabs namely 5 per cent, 12 per cent, 18 per cent and 28 per cent for all goods or services.
7. Exports and supplies to SEZ are zero-rated.
8. There are various modes of payment of tax available to the taxpayer, including Internet banking, debit/credit card and National Electronic Funds Transfer (NEFT)/Real Time Gross Settlement (RTGS).

GST Council – Constitution

- Chairperson: Finance Minister
- Vice Chairperson is to be chosen amongst the Ministers of State Government
- Members: MoS (Finance) and all Ministers of Finance/Taxation of each State
- Quorum is 50% of total members
- States have two-third weightage and Centre has one-third weightage
- Decision is taken by 75% majority
- The Council shall make recommendations on everything related to GST including, rules and rates, etc.



10.6 Role of Commerce and Industry Associations is in Promotion of Internal Trade

Associations of business and industrial houses are formed to promote and protect their common interest and goals. Many such associations have been formed and are present in the country such as Associated Chamber of Commerce and Industry (ASSOCHAM), Confederation of Indian Industry (CII) and Federation of Indian Chambers of Commerce and Industry (FICCI). These associations or chambers act as the national guardians of trade, commerce and industry.

These associations have been playing a catalytic role in strengthening internal trade to make it an important part of overall economic activity.The Chambers of Commerce and Industry interact with the government at different levels to reorient or put in place policies which reduce hindrances, increase interstate movement of goods, introduce transparency and remove multiple layers of inspection and bureaucratic hurdles. Besides, the chambers also aim at erecting sound infrastructure and simplifying and harmonising the tax structures. The interventions are mainly in the following areas:

(i) Interstate movement of goods: The Chambers of Commerce and Industry help in many activities concerning inter state movement of goods which include registration of vehicles, surface transport policies, construction of highways and roads. For example, the construction of golden quadrilateral corridor announced by the Prime Minister of India in one of the Annual General Meetings of the Federation of Indian Chambers of Commerce and Industry (FICCI) will facilitate internal trade.

(ii) Octroi and other local levies: Octroi and local taxes are the important sources of revenue of the local government. These are collected on the goods and from people entering the state or the municipal limits. The Chambers of Commerce try to ensure that their imposition is not at the cost of smooth transportation and local trade.

(iii) Harmonisation of sales tax structure and Value Added Tax: The Chambers of Commerce and Industry play an important role in interacting with the government to harmonise the sales tax structure in different states. The sales tax is an important part of the state revenue. A rational structure of the sales tax and its uniform rates across states, are important for promoting a balance in trade. As per the new policy of the government, the Value Added Tax is being levied in place of the sales tax to remove the cascading effect of the sales tax.

(iv) Marketing of agro products and related issues: The associations of agriculturists and other federations play an important role in the marketing of agro products. Streamlining of local subsidies and marketing policies of organisations selling agro products are some of the areas where the Chambers of Commerce and Industry can really intervene and interact with concerned agencies like farming cooperatives.

(v) Weights and Measures and prevention of duplication brands: Laws relating to weights and measures and protection of brands are necessary to protect the interest of the consumers as well as the traders. These need to be enforced strictly. The Chambers of Commerce and Industry interact with the government to formulate such laws and take action against those who violate rules and regulations.

(vi) Excise duty: Central excise is the chief source of the government revenue levied across states by the central government. The excise policy plays an important role in pricing mechanism. The trade associations need to interact with the government to ensure streamlining of excise duties.

(vii) Promoting sound infrastructure: A sound infrastructure like road, port, electricity, railways etc., play a catalytic role in promoting trade. The Chambers of Commerce and Industry hold discussions with government agencies for investments into these projects. **(viii) Labour legislation:** A simple and flexible labour legislation is helpful in running industries, maximising production and generating employment. The Chambers of Commerce and Industry and the government are constantly interacting on issues like labour laws, retrenchment etc. with the government.

Key Terms

Internal trade	Wholesalers	Market traders
Wholesale trade	Retailers	Cheap jacks
Retail trade	Internal retailers	Speciality stores
Departmental stores	Chain stores	Vending machines
	Super markets	Chambers of Commerce

SUMMARY

Trade refers to buying and selling of goods and services with the objective of earning profit on the basis of geographical location of buyers and sellers. It can be classified into two categories (i) internal trade; and (ii) external trade.

Internal trade: Buying and selling of goods and services within the boundaries of a nation are referred to as internal trade. No custom duties or import duties are levied on such trade as goods are part of domestic production and are meant for domestic consumption. Internal trade can be categorised into two broad categories (i) wholesale trade; and (ii) retailing trade.

Wholesale trade: Purchase and sale of goods and services in large quantities for the purposes of resale or intermediate use is referred to as wholesale trade. Wholesalers perform a number of functions in the process of distribution of goods and services and provide valuable services to manufacturers and retailers.

Services of wholesalers: Wholesalers are an important link between manufacturers and retailers. They add value by creating time and place utility.

Services of manufacturers: The services provided by wholesalers to manufacturers include (i) facilitating large scale production; (ii) bearing risk; (iii) providing financial assistance; (iv) expert advice; (v) help in marketing function; (vi) facilitating continuity; and (vii) storage.

Services to retailers: The services provided by wholesalers to retailers include (i) availability of goods (ii) marketing support (iii) grant of credit (iv) specialised knowledge (v) risk sharing

Retail trade: A retailer is a business enterprise that is engaged in the sale of goods and services directly to the ultimate consumers.

Services of retailers: Retailers are an important link between the producers and final consumers. They provide useful service to consumers wholesalers and manufacturers in the distribution of products and services.

Services to manufacturers/wholesalers: Different services provided by retailers to wholesalers and manufacturers include (i) helping distribution of goods; (ii) personal selling; (iii) enabling large scale operations; (iv) collecting market information; and (v) help in promotion of goods and services.

Services to consumers: The different services provided by retailers to consumers include (i) regular availability of products (ii) new product information (iii) convenience of buying (iv) trade selection (v) after sales services and (vi) providing credit facilities.

Types of retail trade: Retail trade can be classified into different types according to their size, type of ownership, on the basis of merchandise handled and whether they have fixed place of business or not. Retailers can be categorised as (i) itinerant retailers; and (ii) fixed shop retailers.

Itinerant retailers: Itinerant retailers are traders who don't have a fixed place of business to operate from. They are small traders operating with limited resources who keep on moving with their wares from street to street or place to place in search of customers. The major types of such retailers are:

(i) Peddlers and hawkers: They are small producers or petty traders who carry the products on a bicycle or handcart or on their heads and move from place to place, to sell their goods at the doorstep of the customers.

(ii) Market traders: Market traders are small retailers who open their shops at different places on fixed days/dates, catering mainly to lower income group of customers and dealing in low priced consumer items of daily use.

(iii) Street trades: Street traders are the small retailers who are commonly found at places where huge floating population gathers.

(iv) Cheap jacks: Cheap jacks are those petty retailers who have independent shops of a temporary nature in a business location. They deal in consumer items and provide services to consumers in terms of making the products available where needed.

Fixed shop retailers: On the basis of size of operations, (fixed shop retailers can be classified as a) small shopkeepers and (b) large retailers.

Fixed shop small retailers

(i) General stores: General stores carry stock of a variety of products such as grocery items, soft drinks, toiletry products, confectionery, and stationery, needed to satisfy day-to-day needs of consumers, residing in nearby localities.

(ii) Speciality shops: Speciality shops specialise in the sale of specific line of products such as children's garments, men's wear, ladies shoes, school uniform, college books or consumer electronic goods, etc.,

(iii) Street stall holders: These small vendors are commonly found at street crossing or other places where flow of traffic is heavy and deal mainly in goods of cheap variety like hosiery products, toys, cigarettes, soft drinks, etc.

(iv) Second hand goods shop: These shops deals in second hand or used goods of different kinds like furniture, books, clothes and other household articles which are sold at lower prices.

(v) Single line stores: Single line stores deal in a single product line such as ready made garments, watches, shoes etc., and keep variety of items of the same line and are situated at central location.

Fixed shop large stores: In fixed shop large stores, the volume and variety of goods stocked is large.

Departmental stores: A departmental store is a large establishment offering a wide variety of products, classified into well-designed departments, aimed at satisfying practically every customer's need under one roof.

Advantages: (a) attracts large number of customers (b) convenience in buying (c) attractive services (d) economy of large scale operation (e) promotion of sales.

Limitations: (a) lacks personal attention (b) high operating cost (c) high possibility of loss (d) inconvenient location.

Chain stores or multiple shops: These shops are networks of retail shops that are owned and operated by manufacturers or intermediaries dealing in standardised and branded consumer products having rapid sales turnover.

Advantages: (a) economies of scale (b) elimination of middlemen (c) no bad debts (d) transfer of goods (e) diffusion of risk (e) low cost (f) flexibility.

Limitations: (a) limited selection of goods (b) lack of initiative (c) lack of personal touch (d) difficult to change demand.

Difference between Departmental Stores and Multiple Shops: (a) location (b) range of products (c) services offered (d) pricing (e) class of customers (f) credit facilities (g) flexibility.

Mail order houses: Mail order houses are retail outlets that sell their merchandise through mail, without any direct personal contact with the buyers.

Advantages: (a) limited capital requirements (b) elimination of middlemen, (c) absence of bad debts (d) wide reach (e) convenience.

Limitations: (a) lack of personal contact, (b) high promotion cost (c) no after sales services (d) no credit facilities (e) delayed delivery (f) possibility of abuse (g) high dependence on postal services.

Consumer cooperative stores: A consumer cooperative store is an organisation owned managed and controlled by consumers themselves formed with the objective of reducing the number of middlemen and thereby providing services to members.

Advantages: (i) ease in formation (ii) limited liability (iii) democratic management (iv) lower prices (v) cash sales (vi) convenient location.

Limitations: (i) lack of initiative (ii)shortage of funds (iii) lack of patronage (iv) lack of business training.

Super markets: A super market is a large retailing business unit selling wide variety of consumer goods on the basis of low margin appeal, wide variety and assortment and heavy emphasis on merchandising appeal.

Advantages: (i) one roof, low cost (ii) central location (iii) wide selection (iv) no bad debts (v) benefits of large scale.

Limitations: (a) no credit (b) no personal attention (c) mishandling of goods (d) high over head expenses (e) huge capital requirements.

Vending Machines: Vending machines are proving useful in selling pre-packed brands of low priced products which have high turnover and which are uniform in size and weight.

EXERCISES

Short Answer Questions

1. What is meant by internal trade?
2. Specify the characteristics of fixed shop retailers.
3. What purpose is served by wholesalers providing warehousing facilities?
4. How does market information provided by the wholesalers benefit the manufacturers?
5. How does the wholesaler help the manufacturer in availing the economies of scale?
6. Distinguish between single line stores and speciality stores. Can you identify such stores in your locality?

7. How would you differentiate between street traders and street shops?
8. Explain the services offered by wholesalers to manufacturers.
9. What are the services offered by retailers to wholesalers and consumers?

Long Answer Questions

1. Itinerant traders have been an integral part of internal trade in India. Analyse the reasons for their survival in spite of competition from large scale retailers.
2. Discuss the features of a departmental store. How are they different from multiple shops or chain stores.
3. Why are consumer cooperative stores considered to be less expensive? What are its relative advantages over other large scale retailers?
4. Imagine life without your local market. What difficulties would a consumer face if there is no retail shop?
5. Explain the usefulness of mail orders houses. What type of products are generally handled by them? Specify.

Projects/Assignments

1. Identify various fixed shop retailers in your locality and classify them according to the different types you have studied.
2. Do you know any retailers selling second-hand goods in your area? Find out the category of the product that they deal in? Which products are suitable for resale? List some of your findings. What conclusions do you draw?
3. Do you observe any difference in the retail business of yesterday and the times to come. Prepare a brief write-up and discuss it in class.
4. From you own experience, compare the features of two retail stores selling the same product. For example, the same products being sold at a small scale retailer like a general store and in a big store like a departmental store. What similarities and differences can you identify in terms of price, service, variety, convenience, etc.
5. The GST has been rolled out by the Government of India on July, 01, 2017. Different goods and services are classified under GST rates viz., 0%, 5%, 12%, 18% and 28%. Collect the information on GST from newspapers, media news, Internet and business magazines and classify the given goods and services five GST rates :

Activity: Classification of GST Rates of different Goods and Services

Items	**No tax (0%)**	**5%**	**12%**	**18%**	**28%**
Jute					
Newspaper					
Coffee/Tea					
Shampoo					
Washing Machine					
Motorcycles					
Vegetables					
Milk					
Curd					
Salt					
Spices					
Kerosene					
Kites					
Apparel above Rs 1000					
Cheese					
Ghee					
Fruit Juices					
Bhujia					
Ayurvedic Medicines					
Sewing Machine					
Cell Phones					
Ketchup & Sauces					
Exercise Books					
Notebooks					
Spectacles					
Non-AC					
Fertilisers					
Biscuits					
Pasta					
Pastries and cakes					
Jams					
Mineral Water					
Steel					
Products					
Camera					
Speakers and monitors					
Aluminum Foil					
CCTV					
Telecom Services					
Branded Garments					

CHAPTER 11

INTERNATIONAL BUSINESS

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- State the meaning of International Business
- Distinguish between Internal and International Business
- Discuss the scope of International Business
- Enumerate the benefits of International Business
- Discuss the documents required for import and export transactions
- Identify the incentives and schemes available for international firms
- Discuss the role of different organisations for the promotion of International Business
- List the major international institutions and agreements at the global level for the promotion of international trade and development.

Mr. Sudhir Manchanda is a small manufacturer of automobile components. His factory is located in Gurgaon and employs about 55 workers with an investment of Rs. 9.2 million in plant and machinery. Due to recession in the domestic market, he foresees prospects of his sales going up in the next few years in the domestic market. He is exploring the possibility of going international. Some of his competitors are already in export business. A casual talk with one of his close friends in the tyre business reveals that there is a substantial market for automobile components and accessories in South-East Asia and Middle East. But his friend also tells him, "Doing business internationally is not the same as carrying out business within the home country. International business is more complex as one has to operate under market conditions that are different from those that one faces in domestic business". Mr. Manchanda is, moreover, not sure as to how he should go about setting up international business. Should he himself identify and contact some overseas customers and start exporting directly to them or else route his products through export houses which specialise in exporting products made by others?

Mr. Manchanda's son who has just returned after an MBA in USA suggests that they should set up a fully owned factory in Bangkok for supplying to customers in South-East Asia and Middle East. Setting up a manufacturing plant there will help them save costs of transporting goods from India. This would also help them coming closer to the overseas customers. Mr. Manchanda is in a fix as to what to do. In the face of difficulties involved in overseas ventures as pointed out by his friend, he is wondering about the desirability of entering into global business. He is also not sure as to what the different ways of entering into international market are and which one will best suit his purpose.

11.1 Introduction

Countries all over the world are undergoing a fundamental shift in the way they produce and market various products and services. The national economies which so far were pursuing the goal of self-reliance are now becoming increasingly dependent upon others for procuring as well as supplying various kinds of goods and services. Due to increased cross border trade and investments, countries are no more isolated.

The prime reason behind this radical change is the development of communication, technology, infrastructure etc. Emergence of newer modes of communication and development of faster and more efficient means of transportation have brought nations closer to one another. Countries that were cut-off from one another due to geographical distances and socio-economic differences have now started increasingly interacting with others. World Trade Organisation (WTO) and reforms carried out by the governments of different countries have also been a major contributory factor to the increased interactions and business relations amongst the nations.

We are today living in a world where the obstacles to cross-border movement of goods and persons have substantially come down. The national economies are increasingly becoming borderless and getting integrated into the world economy. Little wonder that the world has today come to be known as a 'global village'. Business in the present day is no longer restricted to the boundaries of the domestic country. More and more firms are making forays into international business which presents them with numerous opportunities for growth and increased profits.

India has been trading with other countries for a long time. But it has of late considerably speeded up its process of integrating with the world economy and increasing its foreign trade and investments (see Box A: India Embarks on the Path to Globalisation).

11.1.1 Meaning of International Business

Business transaction taking place within the geographical boundaries of a nation is known as domestic or national business. It is also referred to as internal business or home trade. Manufacturing and trade beyond the boundaries of one's own country is known as international business. International or external business can, therefore, be defined as those business activities that take place across the

Box A
India Embarks on the Path to Globalisation

International business has entered into a new era of reforms. India too did not remain cut-off from these developments. India was under a severe debt trap and was facing crippling balance of payment crisis. In 1991, it approached the International Monetary Fund (IMF) for raising funds to tide over its balance of payment deficits. IMF agreed to lend money to India subject to the condition that India would undergo structural changes to be able to ensure repayment of borrowed funds.

India had no alternative but to agree to the proposal. It was the very conditions imposed by IMF which more or less forced India to liberalise its economic policies. Since then a fairly large amount of liberalisation at the economic front has taken place.

Though the process of reforms has somewhat slowed down, India is very much on the path to globalisation and integrating with the world economy. While, on the one hand, many multinational corporations (MNCs) have ventured into Indian market for selling their products and services; many Indian companies too have stepped out of the country to market their products and services to consumers in foreign countries.

national frontiers. It involves not only the international movements of goods and services, but also of capital, personnel, technology and intellectual property like patents, trademarks, know-how and copyrights.

It may be mentioned here that mostly people think of international business as international trade. But this is not true. No doubt international trade, comprising exports and imports of goods, has historically been an important component of international business. But of late, the scope of international business has substantially expanded. International trade in services such as international travel and tourism, transportation, communication, banking, warehousing, distribution and advertising has considerably grown. The other equally important developments are increased foreign investments and overseas production of goods and services. Companies have started increasingly making investments into foreign countries and undertaking production of goods and services in foreign countries to come closer to foreign customers and serve them more effectively at lower costs. All these activities form part of international business. To conclude, we can say that international business is a much broader term and is comprised of both the trade and production of goods and services across frontiers.

11.1.2 Reason for International Business

The fundamental reason behind international business is that the countries cannot produce equally well or cheaply all that they need. This is because of the unequal distribution of natural resources among them or differences in their productivity levels. Availability of various factors of production such as labour, capital and raw materials that are required for producing different goods and services differ among nations. Moreover, labour productivity and production costs differ among nations due to various socio-economic, geographical and political reasons.

Due to these differences, it is not uncommon to find one particular country being in a better position to produce better quality products and/ or at lower costs than what other nations can do. In other words, we can say that some countries are in an advantageous position in producing select goods and services which other countries cannot produce that effectively and efficiently, and vice-versa. As a result, each country finds it advantageous to produce those select goods and services that it can produce more effectively and efficiently at home, and procuring the rest through trade with other countries which the other countries can produce at lower costs. This is precisely the reason as to why countries trade with others and engage in what is known as international business.

The international business as it exists today is to a great extent the result of geographical specialisation as pointed out above. Fundamentally, it is for the same reason that domestic trade between two states or regions within a country takes place. Most states or regions within a country tend to specialise in the production of goods and services for which they are best suited. In India, for example, while West Bengal specialises in jute products; Mumbai and neighbouring areas in Maharashtra are more involved with the production of cotton textiles. The same principle of territorial division of labour is applicable at the international level too. Most developing countries which are labour abundant, for instance, specialise in producing and exporting garments. Since they lack capital and technology, they import textile machinery from the developed nations which the latter are in a position to produce more efficiently.

What is true for the nation is more or less true for firms. Firms too engage in international business to import what is available at lower prices in other countries, and export goods to other countries where they can fetch better prices for their products. Besides price considerations, there are several other benefits which nations and firms derive from international business. In a way, these other benefits too provide an impetus to nations and firms to engage in international business. We shall turn our attention to some of these benefits accruing to nations and firms from engaging in international business in a later section.

11.1.3 International Business vs. Domestic Business

Conducting and managing international business operations is more complex than undertaking domestic business. Because of variations in political, social, cultural and economic environments across countries, business firms find it difficult to extend their domestic business strategy to foreign markets. To be successful in the overseas markets, they need to adapt their product, pricing, promotion and distribution strategies and overall business plans to suit the specific requirements of the target foreign markets (see Box B on Firms need to be Cognisant of Environmental Differences). Key aspects in respect of which domestic and international businesses differ from each other are discussed below.

(i) Nationality of buyers and sellers: Nationality of the key participants (i.e., buyers and sellers) to the business deals differs between domestic and international businesses. In the case of domestic business, both the buyers and sellers are from the same country. This makes it easier for both the parties to understand each other and enter into business deals. But this is not the case with international business where buyers and sellers come from different countries. Because of differences in their languages, attitudes, social customs and business goals and practices, it becomes relatively more difficult for them to interact with one another and finalise business transactions.

(ii) Nationality of other stakeholders: Domestic and international businesses also differ in respect of the nationalities of the other stakeholders such as employees, suppliers, shareholders/ partners and general public who interact with business firms. While in the case of domestic business all such factors belong to one country, and therefore relatively speaking depict more consistency in their value systems and behaviours; decision making in international business becomes much more complex as the concerned business firms have to take into account a wider set of values and aspirations of the stakeholders belonging to different nations.

(iii) Mobility of factors of production: The degree of mobility of factors like labour and capital is generally less between countries than within a country. While these factors of movement can move freely within the country, there exist various restrictions to their movement across nations. Apart from legal restrictions, even the variations in socio-cultural environments, geographic influences and economic conditions come in a big way in their movement across countries. This is especially true of the labour which finds it difficult to adjust to the climatic, economic and socio-cultural conditions that differ from country to country.

(iv) Customer heterogeneity across markets: Since buyers in international markets hail from different countries, they differ in their socio-cultural background. Differences in their tastes, fashions, languages, beliefs and customs, attitudes and product preferences cause variations in not only their demand for different products and services, but also in variations in their communication patterns and purchase behaviours. It is precisely because of the socio-cultural differences that while

Box B
Firms need to be Cognisant of Environmental Differences

It is to be kept in mind that conducting and managing international business is not an easy venture. It is more difficult to manage international business operations due to variations in the political, social, cultural and economic environments that differ from country to country.

Simply being aware of these differences is not sufficient. One also needs to be sensitive and responsive to these changes by way of introducing adaptations in their marketing programmes and business strategies. It is, for instance, a well known fact that because of poor lower per capita income, consumers in most of the developing African and Asian countries are price sensitive and prefer to buy less expensive products. But consumers in the developed countries like Japan, United States, Canada, France, Germany and Switzerland have a marked preference for high quality and high priced products due to their better ability to pay. Business prudence, therefore, demands that the firms interested in marketing to these countries are aware of such differences among the countries, and design their strategies accordingly. It will be in the fitness of things if the firms interested in exporting to these countries produce less expensive products for the consumers in the African and Asian regions, and design and develop high quality products for consumers in Japan and most of the European and North American countries.

people in China prefer bicycles, the Japanese in contrast like to ride bikes. Similarly, while people in India use right-hand driven cars, Americans drive cars fitted with steering, brakes, etc., on the left side. Moreover, while people in the United States change their TV, bike and other consumer durables very frequently — within two to three years of their purchase, Indians mostly do not go in for such replacements until the products currently with them have totally worn out.

Such variations greatly complicate the task of designing products and evolving strategies appropriate for customers in different countries. Though to some extent customers within a country too differ in their tastes and preferences. These differences become more striking when we compare customers across nations.

(v) Differences in business systems and practices: The differences in business systems and practices are considerably much more among countries than within a country. Countries differ from one another in terms of their socio-economic development, availability, cost and efficiency of economic infrastructure and market support services, and business customs and practices due to their socio-economic milieu and historical coincidences. All such differences make it necessary for firms interested in entering into international markets to adapt their production, finance, human resource and marketing plans as per the conditions prevailing in the international markets.

(vi) Political system and risks: Political factors such as the type of government, political party system, political ideology, political risks, etc., have a profound impact on business operations. Since a business person is familiar with the political environment of his/her country, he/she can well understand it and predict its impact on business operations. But this is not the case with international business. Political environment differs from one country to another. One needs to make special efforts to understand the differing political environments and their business implications. Since political environment keeps on changing, one needs to monitor political changes on an ongoing basis in the concerned countries and devise strategies to deal with diverse political risks.

A major problem with a foreign country's political environment is a tendency among nations to favour products and services originating in their own countries to those coming from other countries. While this is not a problem for business firms operating domestically, it quite often becomes a severe problem for the firms interested in exporting their goods and services to other nations or setting up their plants in the overseas markets.

(vii) Business regulations and policies: Coupled with its socio-economic environment and political philosophy, each country evolves its own set of business laws and regulations. Though these laws, regulations and economic policies are more or less uniformly applicable within a country, they differ widely among nations. Tariff and taxation policies, import quota system, subsidies and other controls adopted by a nation are not the same as in other countries and often discriminate against foreign products, services and capital.

(viii) Currency used in business transactions: Another important difference between domestic and international business is that the latter involves the use of different currencies. Since the exchange rate, i.e., the price of one currency expressed in relation to that of another country's currency, keeps on fluctuating, it adds to the problems of international business firms in fixing prices of their products and hedging against foreign exchange risks.

11.1.4 Scope of International Business

As pointed out earlier, international business is much broader than international trade. It includes not only international trade (i.e., export and import of goods and services), but also a wide variety of other ways in which the firms operate internationally. Major forms of business operations that constitute international business are as follows.

(i) Merchandise exports and imports: Merchandise means goods that are tangible, i.e., those that can be seen and touched. When viewed from this perceptive, it is clear that while merchandise exports means sending tangible goods abroad, merchandise imports means bringing tangible goods from a foreign country to one's own country. Merchandise exports and imports, also known as trade in goods, include only tangible goods and exclude trade in services.

(ii) Service exports and imports: Service exports and imports involve trade in intangibles. It is because of the intangible aspect of services that trade in services is also known as *invisible trade*. A wide variety of services are traded internationally and these include: tourism and travel, boarding and lodging (hotel and restaurants), entertainment and recreation, transportation, professional services (such as training, recruitment, consultancy and research), communication (postal, telephone, fax, courier and other audio-visual services), construction and engineering, marketing (e.g., wholesaling, retailing, advertising, marketing research and warehousing), educational and financial services (such as banking and insurance). Of these, tourism, transportation and business services are major constituents of world trade in services (see Box C).

(iii) Licensing and franchising: Permitting another party in a foreign country to produce and sell goods under your trademarks, patents or copy rights in lieu of some fee is another way of entering into international business. It is under the licensing system that Pepsi and Coca Cola are produced and sold all over the world by local bottlers in foreign countries. Franchising is similar to licensing, but it is a term used in connection with the provision of

Table 11.1 Major Difference between Domestic and International Business

Basis	Domestic business	International business
1. Nationality of buyers and sellers	People or organisations from one nation participate in domestic business transactions.	People or organisations of different countries participate in international business transactions.
2. Nationality of other stakeholders	Various other stakeholders such as suppliers, employees, middlemen, shareholders and partners are usually citizens of the same country.	Various other stakeholders such as suppliers, employees, middlemen, shareholders and partners are from different nations.
3. Mobility of factors of production	The degree of mobility of factors of production like labour and capital is relatively more within a country.	The degree of mobility of factors of production like labour and capital across nations is relatively less.
4. Customer heterogeneity across markets	Domestic markets are relatively more homogeneous in nature.	International markets lack homogeneity due to differences in language, preferences, customs, etc., across markets.
5. Differences in business systems and practices	Business systems and practices are relatively more homogeneous within a country.	Business systems and practices vary considerably across countries.
6. Political system and risks	Domestic business is subject to political system and risks of one single country.	Different countries have different forms of political systems and different degrees of risks which often become a barrier to international business.
7. Business regulations and policies	Domestic business is subject to rules, laws and policies, taxation system, etc., of a single country.	International business transactions are subject to rules, laws and policies, tariffs and quotas, etc. of multiple countries.
8. Currency used in business transactions	Currency of domestic country is used.	International business transactions involve use of currencies of more than one country.

services. McDonalds, for instance, operates fast food restaurants the world over through its franchising system.

(iv) Foreign investments: Foreign investment is another important form of international business. Foreign investment involves investments of funds abroad in exchange for financial return. Foreign investment can be of two types: direct and portfolio investments.

Direct investment takes place when a company directly invests in properties such as plant and machinery in foreign countries with a view to undertaking production and marketing of goods and services in those countries. Direct investment provides the investor a controlling interest in a foreign company, known as Direct Investment, i.e., FDI. It can be in the form of joint venture on PPP. A company, if it so desires, can also set up a *wholly owned subsidiary* abroad by making 100 per cent investment in foreign ventures, and thus acquiring full control over subsidiary's operations in the foreign market.

A portfolio investment, on the other hand, is an investment that a company makes into another company by the way of acquiring shares or providing loans to the latter, and earns income by way of dividends or interest on loans. Unlike foreign direct investments, the investor under portfolio investment does not get directly involved into production and marketing operations. It simply earns an income by investing in shares, bonds, bills, or notes in a foreign country or providing loans to foreign business firms.

Box C
Tourism, Transportation and Business Services dominate International Trade in Services

Tourism and transportation have emerged as major components of international trade in services. Most of the airlines, shipping companies, travel agencies and hotels get their major share of revenues from their overseas customers and operations abroad. Several countries have come to heavily depend on services as an important source of foreign exchange earnings and employment. India, for example, earns a sizeable amount of foreign exchange from exports of services related to travel and tourism.

Business services: When one country provides services to other country and in the process earns foreign exchange, this is also treated as a form of international business activity. Fee received for services like banking, insurance, rentals, engineering and management services form part of country's foreign exchange earnings. Undertaking of construction projects in foreign countries is also an example of export of business services. The other examples of such services include overseas management contracts where arrangements are made by one company of a country which provides personnel to perform general or specialised management functions for another company in a foreign country in lieu of the other country.

11.1.5 Benefits of International Business

Notwithstanding greater complexities and risks, international business is important to both nations and business firms. It offers them several benefits. Growing realisation of these benefits over time has in fact been a contributory factor to the expansion of trade and investment amongst nations, resulting in the phenomenon of globalisation. Some of the benefits of international business to the nations and business firms are discussed below.

Benefits to Countries

(i) Earning of foreign exchange: International business helps a country to earn foreign exchange which it can later use for meeting its imports of capital goods, technology, petroleum products and fertilisers, pharmaceutical products and a host of other consumer products which otherwise might not be available domestically.

(ii) More efficient use of resources: As stated earlier, international business operates on a simple principle — produce what your country can produce more efficiently, and trade the surplus production so generated with other countries to procure what they can produce more efficiently. When countries trade on this principle, they end up producing much more than what they can when each of them attempts to produce all the goods and services on its own. If such an enhanced pool of goods and services is distributed equitably amongst nations, it benefits all the trading nations.

(iii) Improving growth prospects and employment potentials: Producing solely for the purposes of domestic consumption severely restricts a country's prospects for growth and employment. Many countries, especially the developing ones, could not execute their plans to produce on a larger scale, and thus create employment for people because their domestic market was not large enough to absorb all that extra production. Later on a few countries such as Singapore, South Korea and China which saw markets for their products in the foreign countries embarked upon the strategy 'export and flourish', and soon became the star performers on the world map. This helped them not only in improving their growth prospects, but also created opportunities for employment of people living in these countries.

(iv) Increased standard of living: In the absence of international trade of goods and services, it would not have been possible for the world community to consume goods and services produced in other countries that the people in these countries are able to consume and enjoy a higher standard of living.

Benefits to Firms

(i) Prospects for higher profits: International business can be more profitable than the domestic business. When the domestic prices are lower, business firms can earn more profits by selling their products in countries where prices are high.

(ii) Increased capacity utilisation: Many firms setup production capacities for their products which are in excess of demand in the domestic market. By planning overseas expansion and procuring orders from foreign customers, they can think of making use of their surplus production capacities and also improving the profitability of their operations. Production on a larger scale often leads to economies of scale, which in turn lowers production cost and improves per unit profit margin.

(iii) Prospects for growth: Business firms find it quite frustrating when demand for their products starts getting saturated in the domestic market. Such firms can considerably improve prospects of their growth by plunging into overseas markets. This is precisely what has prompted many of the multinationals from the developed countries to enter into markets of developing countries. While demand in their home countries has got almost saturated, they realised their products were in demand in the developing countries and demand was picking up quite fast.

(iv) Way out to intense competition in domestic market: When competition in the domestic market is very intense, internationalisation seems to be the only way to achieve significant growth. Highly competitive domestic market drives many companies to go international in search of markets for their products. International business thus acts as a catalyst of growth for firms facing tough market conditions on the domestic turf.

(v) Improved business vision: The growth of international business of many companies is essentially a part of their business policies or strategic management. The vision to become international comes from the urge to grow, the need to become more competitive, the need to diversify and to gain strategic advantages of internationalisation.

11.2 Modes of Entry into International Business

Simply speaking, the term mode means the manner or way. The phrase 'modes of entry into international business', therefore, means various ways in which a company can enter into international business. While discussing the meaning and scope of international business, we have already familiarised you with some of the modes of entry into international business. In the following sections, we shall discuss in detail important ways of entering into international business along with their advantages and limitations. Such a discussion will enable you to know as to which mode is more suitable under what conditions.

11.2.1 Exporting and Importing

Exporting refers to sending of goods and services from the home country to a foreign country. In a similar vein, importing is purchase of foreign products and bringing them into one's home country. There are two important ways in which a firm can export or import products: direct and indirect exporting/importing. In the case of direct exporting/importing, a firm itself approaches the overseas buyers/ suppliers and looks after all the formalities related to exporting/ importing activities including those related to shipment and financing of goods and services. Indirect exporting/ importing, on the other hand, is one where the firm's participation in the export/import operations is minimum, and most of the tasks relating to export/import of the goods are carried out by some middle men such as export houses or buying offices of overseas customers located in the home country or wholesale importers in the case of import operations. Such firms do not directly deal with overseas customers in the case of exports and suppliers in the case of imports.

Advantages

Major advantages of exporting include:

- As compared to other modes of entry, exporting/importing is the easiest way of gaining entry into international markets. It is less complex an activity than setting up and managing joint-ventures or wholly owned subsidiaries abroad.
- Exporting/importing is less involving in the sense that business firms are not required to invest that much time and money as is needed when they desire to enter into joint ventures or set up manufacturing plants and facilities in host countries.
- Since exporting/importing does not require much of investment in foreign countries, exposure to foreign investment risks is nil or much lower than that is present when firms opt for other modes of entry into international business.

Limitations

Major limitations of exporting/ importing as an entry mode of international business are as follows:

- Since the goods physically move from one country to another, exporting/importing involves additional packaging, transportation and insurance costs. Especially in the case of heavy items, transportation costs alone become an inhibiting factor to their exports and imports. On reaching the shores of foreign countries, such products are subject to custom duty and a variety of other levies and charges. Taken together, all these expenses and payments substantially increase product costs and make them less competitive.
- Exporting is not a feasible option when import restrictions exist in a foreign country. In such a situation, firms have no alternative but to opt for other entry modes such as licensing/franchising or joint venture which makes it feasible to make the product available by way of producing and

marketing it locally in foreign countries.

- Export firms basically operate from their home country. They produce in the home country and then ship the goods to foreign countries. Except a few visits made by the executives of export firms to foreign countries to promote their products, the export firms in general do not have much contact with the foreign markets. This puts the export firms in a disadvantageous position vis-à-vis the local firms which are very near the customers and are able to better understand and serve them.

Despite the above mentioned limitations, exporting/importing is the most preferred way for business firms when they are getting initially involved with international business. As usually is the case, firms start their overseas operations with exports and imports, and later having gained familiarity with the foreign market operations switch over to other forms of international business operations.

11.2.2 Contract Manufacturing

Contract manufacturing refers to a type of international business where a firm enters into a contract with one or a few local manufacturers in foreign countries to get certain components or goods produced as per its specifications. Contract manufacturing, also known as *outsourcing*, can take three major forms:

- Production of certain components such as automobile components or shoe uppers to be used later for producing final products such as cars and shoes;
- Assembly of components into final products such as assembly of hard disk, mother board, floppy disk drive and modem chip into computers; and
- Complete manufacture of the products such as garments.

The goods are produced or assembled by the local manufacturers as per the technology and management guidance provided to them by the foreign company. The goods so manufactured or assembled by the local producers are delivered to the international firm for use in its final products or out rightly sold as finished products by the international firm under its brand names in various countries including the home, host and other countries. All the major international companies such as Nike, Reebok, Levis and Wrangler today get their products or components produced in the developing countries under contract manufacturing.

Advantages

Contract manufacturing offers several advantages to both the international company and local producers in the foreign countries.

- Contract manufacturing permits the international firms to get the goods produced on a large scale without requiring investment in setting up production facilities. These firms make use of the production facilities already existing in the foreign countries.

- Since there is no or little investment in the foreign countries, there is hardly any investment risk involved in the foreign countries.
- Contract manufacturing also gives an advantage to the international company of getting products manufactured or assembled at lower costs especially if the local producers happen to be situated in countries which have lower material and labour costs.
- Local producers in foreign countries also gain from contract manufacturing. If they have any idle production capacities, manufacturing jobs obtained on contract basis in a way provide a ready market for their products and ensure greater utilisation of their production capacities. This is how the Godrej group is benefitting from contract manufacturing in India. It is manufacturing soaps under contract for many multinationals including Dettol soap for Reckitt and Colman. This has considerably helped it in making use of its excess soap manufacturing capacity.
- The local manufacturer also gets the opportunity to get involved with international business and avail incentives, if any, available to the export firms in case the international firm desires goods so produced be delivered to its home country or to some other foreign countries.

Limitations

The major disadvantages of contract manufacturing to international firm and local producer in foreign countries are as follows:

- Local firms might not adhere to production design and quality standards, thus causing serious product quality problems to the international firm.
- Local manufacturer in the foreign country loses his control over the manufacturing process because goods are produced strictly as per the terms and specifications of the contract.
- The local firm producing under contract manufacturing is not free to sell the contracted output as per its will. It has to sell the goods to the international company at predetermined prices. This results in lower profits for the local firm if the open market prices for such goods happen to be higher than the prices agreed upon under the contract.

11.2.3 Licensing and Franchising

Licensing is a contractual arrangement in which one firm grants access to its patents, trade secrets or technology to another firm in a foreign country for a fee called royalty. The firm that grants such permission to the other firm is known as *licensor* and the other firm in the foreign country that acquires such rights to use technology or patents is called the *licensee*. It may be mentioned here that it is not only technology that is licensed. In the fashion industry, a number of designers license the use of their names. In some cases, there is exchange of technology between the two firms. Sometimes there is mutual exchange of knowledge, technology and/or patents between the firms which is known as *cross-licensing*.

Franchising is a term very similar to licensing. One major distinction between the two is that while the former is used in connection with production and marketing of goods, the term franchising applies to service business. The other point of difference between the two is that franchising is relatively more stringent than licensing. Franchisers usually set strict rules and regulations as to how the franchisees should operate while running their business. Barring these two differences, franchising is pretty much the same as licensing. Like in the case of licensing, a franchising agreement too involves grant of rights by one party to another for use of technology, trademark and patents in return of the agreed payment for a certain period of time. The parent company is called the franchiser and the other party to the agreement is called franchisee. The franchiser can be any service provider be it a restaurant, hotel, travel agency, bank wholesaler or even a retailer - who has developed a unique technique for creating and marketing of services under its own name and trade mark. It is the uniqueness of the technique that gives the franchiser an edge over its competitors in the field, and makes the would-be-service providers interested in joining the franchising system. McDonald, Pizza Hut and Wal-Mart are examples of some of the leading franchisers operating worldwide.

Advantages

As compared to joint ventures and wholly owned subsidiaries, licensing/ franchising is relatively a much easier mode of entering into foreign markets with proven product/technology without much business risks and investments. Some of the specific advantages of licensing are as follows:

- Under the licensing/franchising system, it is the licensor/ franchiser who sets up the business unit and invests his/her own money in the business. As such, the licensor/franchiser has to virtually make no investments abroad. Licensing/franchising is, therefore, considered a less expensive mode of entering into international business.
- Since no or very little foreign investment is involved, licensor/ franchiser is not a party to the losses, if any, that occur to foreign business. Licensor/franchiser is paid by the licensee/franchisee by way of fees fixed in advance as a percentage of production or sales turnover. This royalty or fee keeps accruing to the licensor/franchiser so long as the production and sales keep on taking place in the licensee's/franchisee's business unit.
- Since the business in the foreign country is managed by the licensee/franchisee who is a local

person, there are lower risks of business takeovers or government interventions.

- Licensee/franchisee being a local person has greater market knowledge and contacts which can prove quite helpful to the licensor/franchiser in successfully conducting its marketing operations.
- As per the terms of the licensing/franchising agreement, only the parties to the licensing/franchising agreement are legally entitled to make use of the licensor's/franchiser's copyrights, patents and brand names in foreign countries. As a result, other firms in the foreign market cannot make use of such trademarks and patents.

Limitations

Licensing/franchising as a mode of international business suffers from the following weaknesses.

- When a licensee/franchisee becomes skilled in the manufacture and marketing of the licensed/franchised products, there is a danger that the licensee can start marketing an identical product under a slightly different brand name. This can cause severe competition to the licenser/franchiser.
- If not maintained properly, trade secrets can get divulged to others in the foreign markets. Such lapses on the part of the licensee/franchisee can cause severe losses to the licensor/franchiser.
- Over time, conflicts often develop between the licensor/franchiser and licensee/franchisee over issues such as maintenance of accounts, payment of royalty and non-adherence to norms relating to production of quality products. These differences often result in costly litigations, causing harm to both the parties.

11.2.4 Joint Ventures

Joint venture is a very common strategy for entering into foreign markets. A joint venture means establishing a firm that is jointly owned by two or more otherwise independent firms. In the widest sense of the term, it can also be described as any form of association which implies collaboration for more than a transitory period. A joint ownership venture may be brought about in three major ways:

(i) Foreign investor buying an interest in a local company
(ii) Local firm acquiring an interest in an existing foreign firm
(iii) Both the foreign and local entrepreneurs jointly forming a new enterprise.

Advantages

Major advantages of joint venture include:

- Since the local partner also contributes to the equity capital of such a venture, the international firm finds it financially less burdensome to expand globally.

- Joint ventures make it possible to execute large projects requiring huge capital outlays and manpower.
- The foreign business firm benefits from a local partner's knowledge of the host countries regarding the competitive conditions, culture, language, political systems and business systems.
- In many cases entering into a foreign market is very costly and risky. This can be avoided by sharing costs and/or risks with a local partner under joint venture agreements.

Limitations

Major limitations of a joint venture are discussed below:

- Foreign firms entering into joint ventures share the technology and trade secrets with local firms in foreign countries, thus always running the risks of such a technology and secrets being disclosed to others.
- The dual ownership arrangement may lead to conflicts, resulting in battle for control between the investing firms.

11.2.5 Wholly Owned Subsidiaries

This entry mode of international business is preferred by companies which want to exercise full control over their overseas operations. The parent company acquires full control over the foreign company by making 100 per cent investment in its equity capital. A wholly owned subsidiary in a foreign market can be established in either of the two ways:

(i) Setting up a new firm altogether to start operations in a foreign country — also referred to as a green field venture, or

Foreign Trade Policy (FTP) 2015-20

The Foreign Trade Policy (FTP) 2015-20 provides a stable and sustainable policy environment for foreign trade in merchandise and services, link rules and incentives for exports and imports along with other initiatives, such as 'Make in India', 'Digital India' and 'Skill India' to create 'Export Promotion Mission', promote the diversification of India's exports basket by helping various sectors of the Indian economy to gain global competitiveness, create an architecture for India's global trade as an effort to reduce trade imbalance.

FTP has introduced two major schemes:

1. Merchandise Exports from India Scheme (MEIS) covers agricultural products, like fruits, flowers, vegetables, tea, coffee, spices, handicrafts, handlooms, jute products, textile and garments; tharmaceuticals; surgical; herbal; auto components; telecom; transport; railways; leather; wood; paper, etc.
2. Services exports from India Scheme (SEIS) which covers legal, accounting, architectural, engineering, educational and hospital services at 5%; hotels and restaurants, travel agencies and tour operators and other business services at 3%.

Source : Annual report, 2016-17, Ministry of Commerce

(ii) Acquiring an established firm in the foreign country and using that firm to manufacture and/or promote its products in the host nation.

Advantages

Major advantages of a wholly owned subsidiary in a foreign country are as follows:

- The parent firm is able to exercise full control over its operations in foreign countries.
- Since the parent company on its own looks after the entire operations of foreign subsidiary, it is not required to disclose its technology or trade secrets to others.

Limitations

The limitations of setting up a wholly owned subsidiary abroad include:

- The parent company has to make 100 per cent equity investments in the foreign subsidiaries. This form of international business is, therefore, not suitable for small and medium size firms which do not have enough funds with them to invest abroad.
- Since the parent company owns 100 per cent equity in the foreign company, it alone has to bear the entire losses resulting from failure of its foreign operations.
- Some countries are averse to setting up of 100 per cent wholly owned subsidiaries by foreigners in their countries. This form of international business operations, therefore, becomes subject to higher political risks.

11.3 Export-Import Procedures and Documentation

A major distinction between domestic and international operations is the complexity of the latter. Export and import of goods is not that straight forward as buying and selling in the domestic market. Since foreign trade transactions involves movement of goods across frontiers and use of foreign exchange, a number of formalities are needed to be performed before the goods leave the boundaries of a country and enter into that of another. Following sections are devoted to a discussion of major steps that need to be undertaken for completing export and import transactions.

11.3.1 Export Procedure

The number of steps and the sequence in which these are taken vary from one export transaction to another. Steps involved in a typical export transaction are as follows.

(i) Receipt of enquiry and sending quotations: The prospective buyer of a product sends an enquiry to different exporters requesting them to send information regarding price, quality and terms and conditions for export of goods. Exporters can be informed of such an enquiry even by way of advertisement in the press put in by the importer. The exporter sends a reply to the enquiry in the form of a quotation —

referred to as *proforma invoice*. The proforma invoice contains information about the price at which the exporter is ready to sell the goods and also provides information about the quality, grade, size, weight, mode of delivery, type of packing and payment terms.

(ii) Receipt of order or indent: In case the prospective buyer (i.e., importing firm) finds the export price and other terms and conditions acceptable, it places an order for the goods to be despatched. This order, also known as *indent*, contains a description of the goods ordered, prices to be paid, delivery terms, packing and marking details and delivery instructions.

(iii) Assessing the importer's creditworthiness and securing a guarantee for payments: After receipt of the indent, the exporter makes necessary enquiry about the creditworthiness of the importer. The purpose underlying the enquiry is to assess the risks of non payment by the importer once the goods reach the import destination. To minimise such risks, most exporters demand a *letter of credit* from the importer. A letter of credit is a guarantee issued by the importer's bank that it will honour payment up to a certain amount of export bills to the bank of the exporter. Letter of credit is the most appropriate and secure method of payment adopted to settle international transactions

(iv) Obtaining export licence: Having become assured about payments, the exporting firm initiates the steps relating to compliance of export regulations. Export of goods in India is subject to custom laws which demand that the export firm must have an export licence before it proceeds with exports. Important pre-requisites for getting an export licence are as follows:

- Opening a bank account in any bank authorised by the Reserve Bank of India (RBI) and getting an account number.
- Obtaining Import Export Code (IEC) number from the Directorate General Foreign Trade (DGFT) or Regional Import Export Licensing Authority.
- Registering with appropriate export promotion council.
- Registering with Export Credit and Guarantee Corporation (ECGC) in order to safeguard against risks of non payments.

An export firm needs to have the Import Export Code (IEC) number as it needs to be filled in various export/ import documents. For obtaining the IEC number, a firm has to apply to the Director General for Foreign Trade (DGFT) with documents such as exporter/importer profile, bank receipt for requisite fee, certificate from the banker on the prescribed form, two copies of photographs attested by the banker, details of the non-resident interest and declaration about the applicant's non association with caution listed firms.

It is obligatory for every exporter to get registered with the appropriate export promotion council. Various export promotion councils such as Engineering Export Promotion Council (EEPC) and Apparel Export Promotion Council (AEPC) have been set up by the Government of India to promote and develop exports of different categories of products. We shall discuss about export promotion councils in a later section. But it may be mentioned here that it is necessary for the exporter to become a member of the appropriate export promotion council and obtain a Registration cum Membership Certificate (RCMC) for availing benefits available to export firms from the Government.

Registration with the ECGC is necessary in order to protect overseas payments from political and commercial risks. Such a registration also helps the export firm in getting financial assistance from commercial banks and other financial institutions.

(v) Obtaining pre-shipment finance: Once a confirmed order and also a letter of credit have been received, the exporter approaches his banker for obtaining pre-shipment finance to undertake export production. Pre-shipment finance is the finance that the exporter needs for procuring raw materials and other components, processing and packing of goods and transportation of goods to the port of shipment.

(vi) Production or procurement of goods: Having obtained the pre-shipment finance from the bank, the exporter proceeds to get the goods ready as per the specifications of the importer. Either the firm itself goes in for producing the goods or else it buys from the market.

(vii) Pre-shipment inspection: The Government of India has initiated many steps to ensure that only good quality products are exported from the country. One such step is compulsory inspection of certain products by a competent agency as designated by the government. The government has passed Export Quality Control and Inspection Act, 1963 for this purpose. and has authorised some agencies to act as inspection agencies. If the product to be exported comes under such a category, the exporter needs to contact the Export Inspection Agency (EIA) or the other designated agency for obtaining inspection certificate. The pre-shipment inspection report is required to be submitted along with other export documents at the time of exports. Such an inspection is not compulsory in case the goods are being exported by star trading houses, trading houses, export houses, industrial units setup in export processing zones/special economic zones (EPZs/SEZs) and 100 per cent export oriented units (EOUs). We shall discuss about these special types of export firms in a later section.

(viii) Excise clearance: As per the Central Excise Tariff Act, excise duty is payable on the materials used in manufacturing goods. The exporter, therefore, has to apply to the concerned Excise Commissioner in the region with an invoice. If the Excise Commissioner is satisfied, he may issue the excise clearance. But in many cases the government exempts payment of excise duty or later on refunds it if the goods so manufactured are meant for exports. The idea underlying such exemption or refund is to provide an incentive to the exporters to export more and also to make the export products more competitive in the world markets. The refund of excise duty is known as *duty drawback*. This scheme of duty drawback is presently administered by the Directorate of Drawback under the Ministry of Finance which is responsible for fixing the rates of drawback for different products. The work relating to sanction and payment of drawback is, however, looked after by the Commissioner of Customs or Central Excise Incharge of the concerned port/ airport/land custom station from where the export of goods is considered to have taken place.

(ix) Obtaining certificate of origin: Some importing countries provide tariff concessions or other exemptions to the goods coming from a particular country. For availing such benefits, the importer may ask the exporter to send a *certificate of origin*. The certificate of origin acts as a proof that the goods have actually been manufactured in the country from where the export is taking place. This certificate can be obtained from the trade consulate located in the exporter's country.

(x) Reservation of shipping space: The exporting firm applies to the shipping company for provision of shipping space. It has to specify the types of goods to be exported, probable date of shipment and the port of destination. On acceptance of application for shipping, the shipping company issues a *shipping order*. A shipping order is an instruction to the captain of the ship that the specified goods after their customs clearance at a designated port be received on board.

(xi) Packing and forwarding: The goods are then properly packed and marked with necessary details such as name and address of the importer, gross and net weight, port of shipment and destination, country of origin, etc. The exporter then makes necessary arrangement for transportation of goods to the port. On loading goods into the railway wagon, the railway authorities issue a 'railway receipt' which serves as a title to the goods. The exporter endorses the railway receipt in favour of his agent to enable him to take delivery of goods at the port of shipment.

(xii) Insurance of goods: The exporter then gets the goods insured with an insurance company to protect against the risks of loss or damage of the goods due to the perils of the sea during the transit.

(xiii) Customs clearance: The goods must be cleared from the customs before these can be loaded on the ship. For obtaining customs clearance, the exporter prepares the *shipping bill*. Shipping bill is the main document on the basis of which the customs office gives the permission for export. Shipping bill contains particulars of the goods being exported, the name of the vessel, the port at which goods are to be discharged, country of final destination, exporter's name and address, etc.

Five copies of the shipping bill along with the following documents are then submitted to the Customs Appraiser at the Customs House:

- Export Contract or Export Order
- Letter of Credit
- Commercial Invoice
- Certificate of Origin
- Certificate of Inspection, where necessary
- Marine Insurance Policy

After submission of these documents, the Superintendent of the concerned port trust is approached for obtaining the *carting order*. Carting order is the instruction to the staff at the gate of the port to permit the entry of the cargo inside the dock. After obtaining the carting order, the cargo is physically moved into the port area and stored in the appropriate shed. Since the exporter cannot make himself or herself available all the time for performing all these formalities, these tasks are entrusted to an agent — referred to as Clearing and Forwarding (C&F) agent.

(xiv) Obtaining mates receipt: The goods are then loaded on board the ship for which the mate or the captain of the ship issues *mate's receipt* to the port superintendent. A mate receipt is a receipt issued by the commanding officer of the ship when the cargo is loaded on board, and contains the information about the name of the vessel, berth, date of shipment, descripton of packages, marks and numbers, condition of the cargo at the time of receipt on board the ship, etc. The port superintendent, on receipt of port dues, hands over the mate's receipt to the C&F agent.

(xv) Payment of freight and issuance of bill of lading: The C&F agent surrenders the mates receipt to the shipping company for computation of freight. After receipt of the freight, the shipping company issues a *bill of lading* which serves as an evidence that the shipping company has accepted the goods for carrying to the designated destination. In the case the goods are being sent by air, this document is referred to as *airway bill*.

(xvi) Preparation of invoice: After sending the goods, an invoice of the despatched goods is prepared. The invoice states the quantity of goods sent and the amount to be paid by the importer. The C&F agent gets it duly attested by the customs.

(xvii) Securing payment: After the shipment of goods, the exporter informs the importer about the shipment of goods. The importer needs various documents to claim the title of goods on their arrival at his/her country and getting them customs cleared. The documents that are needed in this connection include certified copy of invoice, bill of lading, packing list, insurance policy, certificate of origin and letter of credit. The exporter sends these documents through his/her banker with the instruction that these may be delivered to the importer after acceptance of the *bill of exchange* — a document which is sent along with the above mentioned documents. Submission of the relevant documents to the bank for the purpose of getting the payment from the bank is called 'negotiation of the documents'.

Bill of exchange is an order to the importer to pay a certain amount of money to, or to the order of, a certain person or to the bearer of the instrument. It can be of two types: document against sight (sight draft) or document against acceptance (usance draft). In case of sight draft, the documents are handed over to the importer only against payment. The moment the importer agrees to sign the sight draft, the relevant documents are delivered. In the case of usance draft, on the other hand, the documents are delivered to the importer against his or her acceptance of the bill of exchange for making payment at the end of a specified period, say three months.

On receiving the bill of exchange, the importer releases the payment in case of sight draft or accepts the usance draft for making payment on maturity of the bill of exchange. The exporter's bank receives the payment through the importer's bank and is credited to the exporter's account.

The exporter, however, need not wait for the payment till the release of money by the importer. The exporter can get immediate payment from his/her bank on the submission of documents by signing a *letter of indemnity*. By signing the letter, the exporter undertakes to indemnify the bank in the event of non-receipt of payment from the importer along with accrued interest.

Having received the payment for exports, the exporter needs to get a bank certificate of payment. Bank certificate of payment is a certificate which says that the necessary documents (including bill of exchange) relating to the particular export consignment has been negotiated (i.e., presented to the importer for payment) and the payment has been received in accordance with the exchange control regulations.

11.3.2 Import Procedure

Import trade refers to purchase of goods from a foreign country. Import procedure differs from country to country depending upon the country's import and custom policies and other statutory requirements. The following paragraphs discuss various steps involved in a typical import transaction for bringing goods into Indian territory.

(i) Trade enquiry: The first thing that the importing firm has to do is to gather information about the countries and firms which export the given product. The importer can gather such information from the trade directories and/or trade associations and organisations. Having identified the countries and firms that export the product, the importing firm approaches the export firms with the help of a *trade enquiry* for collecting information about their export prices and terms of exports. A trade enquiry is a written request by an importing firm to the exporter for supply of information regarding the price and various terms and conditions on which the latter is ready to exports goods.

After receiving a trade enquiry, the exporter prepares a quotation and sends it to the importer. The quotation is known as *proforma invoice.* A proforma invoice is a document that contains details as to the quality, grade, design, size, weight and price of the export product, and the terms and conditions on which their export will take place.

(ii) Procurement of import licence: There are certain goods that can be imported freely, while others need licensing. The importer needs to consult the Export Import (EXIM) policy in force to know whether the goods that he or she wants to import are subject to import licensing. In case goods can be imported only against the licence, the importer needs to procure an import licence. In India, it is obligatory for every importer (and also for exporter) to get registered with the

Major Documents needed in Connection with Export Transaction

A. Documents related to goods

Export invoice: Export invoice is a sellers' bill for merchandise and contains information about goods such as quantity, total value, number of packages, marks on packing, port of destination, name of ship, bill of lading number, terms of delivery and payments, etc.

Packing list: A packing list is a statement of the number of cases or packs and the details of the goods contained in these packs. It gives details of the nature of goods which are being exported and the form in which these are being sent.

Certificate of origin: This is a certificate which specifies the country in which the goods are being produced. This certificate entitles the importer to claim tariff concessions or other exemptions such as non-applicability of quota restrictions on goods originating from certain pre-specified countries. This certificate is also required when there is a ban on imports of certain goods from select countries. The goods are allowed to be brought into the importing country if these are not originating from the banned countries.

Certificate of inspection: For ensuring quality, the government has made it compulsory for certain products that these be inspected by some authorised agency. Export Inspection Council of India (EICI) is one such agency which carries out such inspections and issues the certificate that the consignment has been inspected as required under the Export (Quality Control and Inspection) Act, 1963, and satisfies the conditions relating to quality control and inspection as applicable to it, and is export worthy. Some countries have made this certificate mandatory for the goods being imported to their countries.

B. Documents related to shipment

Mate's receipt: This receipt is given by the commanding officer of the ship to the exporter after the cargo is loaded on the ship. The mate's receipt indicates the name of the vessel, berth, date of shipment, description of packages, marks and numbers, condition of the cargo at the time of receipt on board the ship, etc. The shipping company does not issue the bill of lading unless it receives the mate's receipt.

Shipping Bill: The shipping bill is the main document on the basis of which customs office grants permission for the export. The shipping bill contains particulars of the goods being exported, the name of the vessel, the port at which goods are to be discharged, country of final destination, exporter's name and address, etc.

Bill of lading: Bill of lading is a document wherein a shipping company gives its official receipt of the goods put on board its vessel and at the same time gives an undertaking to carry them to the port of destination. It is also a document of title to the goods and as such is freely transferable by the endorsement and delivery.

Airway Bill: Like a bill of lading, an airway bill is a document wherein an airline company gives its official receipt of the goods on board its aircraft and at the same time gives an undertaking to carry them to the port of destination. It is also a document of title to the goods and as such is freely transferable by the endorsement and delivery.

Marine insurance policy: It is a certificate of insurance contract whereby the insurance company agrees in consideration of a payment called premium to indemnify the insured against loss incurred by the latter in respect of goods exposed to perils of the sea.

Cart ticket: A cart ticket is also known as a cart chit, vehicle or gate pass. It is prepared by the exporter and includes details of the export cargo in terms of the shipper's name, number of packages, shipping bill number, port of destination and the number of the vehicle carrying the cargo.

C. Documents related to payment

Letter of credit: A letter of credit is a guarantee issued by the importer's bank that it will honour up to a certain amount the payment of export bills to the bank of the exporter. Letter of credit is the most appropriate and secure method of payment adopted to settle international transactions

Bill of exchange: It is a written instrument whereby the person issuing the instrument directs the other party to pay a specified amount to a certain person or the bearer of the instrument. In the context of an export-import transaction, bill of exchange is drawn by exporter on the importer asking the latter to pay a certain amount to a certain person or the bearer of the bill of exchange. The documents giving title to the export consignment are passed on to the importer only when the importer accepts the order contained in the bill of exchange.

Bank certificate of payment: Bank certificate of payment is a certificate that the necessary documents (including bill of exchange) relating to the particular export consignment has been negotiated (i.e., presented to the importer for payment) and the payment has been received in accordance with the exchange control regulations.

Directorate General Foreign Trade (DGFT) or Regional Import Export Licensing Authority, and obtain an Import Export Code (IEC) number. This number is required to be mentioned on most of the import documents.

(iii) Obtaining foreign exchange: Since the supplier in the context of an import transaction resides in a foreign country, he/she demands payment in a foreign currency. Payment in foreign currency involves exchange of Indian currency into foreign currency. In India, all foreign exchange transactions are regulated by the Exchange Control Department of the Reserve Bank of India (RBI). As per the rules in force, every importer is required to secure the sanction of foreign exchange. For obtaining such a sanction, the importer has to make an application to a bank authorised by RBI to issue foreign exchange. The application is made in a prescribed form along with the import licence as per the provisions of Exchange Control Act. After proper scrutiny of the application, the bank sanctions the necessary foreign exchange for the import transaction.

(iv) Placing order or indent: After obtaining the import licence, the importer places an import order or indent with the exporter for supply of the specified products. The import order contains information about the price, quantity size, grade and quality of goods ordered and the instructions relating to packing, shipping, ports of shipment and destination, delivery schedule, insurance and mode of payment. The import order should be carefully drafted so as to avoid any ambiguity and consequent conflict between the importer and exporter.

(v) Obtaining letter of credit: If the payment terms agreed between the importer and the overseas supplier is a letter of credit, then the importer should obtain the letter of credit from its bank and forward it to the overseas supplier. As stated previously, a letter of credit is a guarantee issued by the importer's bank that it will honour payment up to a certain amount of export bills to the bank of the exporter. Letter of credit is the most appropriate and secured method of payment adopted to settle international transactions. The exporter wants this document to be sure that there is no risk of non-payment.

(vi) Arranging for finance: The importer should make arrangements in advance to pay to the exporter on arrival of goods at the port. Advanced planning for financing imports is necessary so as to avoid huge demurrages (i.e., penalties) on the imported goods lying uncleared at the port for want of payments.

(vii) Receipt of shipment advice: After loading the goods on the vessel, the overseas supplier dispatches the *shipment advice* to the importer. A shipment advice contains information about the shipment of goods. The information provided in the shipment advice includes details such as invoice number, bill of lading/airways bill number and date, name of the vessel with date, the port of export, description of goods and quantity, and the date of sailing of vessel.

(viii) Retirement of import documents: Having shipped the goods, the overseas supplier prepares a set of necessary documents as per the terms of contract and letter of credit and hands it over to his or her banker for their onward transmission and negotiation to the importer in the manner as specified in the letter of credit. The set of documents normally contains bill of exchange, commercial invoice, bill of lading/airway bill, packing list, certificate of origin, marine insurance policy, etc.

The bill of exchange accompanying the above documents is known as the documentary bill of exchange. As mentioned earlier in connection with the export procedure, documentary bill of exchange can be of two types: documents against payment (sight draft) and documents against acceptance (usance draft). In the case of sight draft, the drawer instructs the bank to hand over the relevant documents to the importer only against payment. But in the case of usance draft, the drawer instructs the bank to hand over the relevant documents to the importer against acceptance of the bill of exchange. The acceptance of bill of exchange for the purpose of getting delivery of the documents is known as *retirement of import documents.* Once the retirement is over, the bank hands over the import documents to the importer.

(ix) Arrival of goods: Goods are shipped by the overseas supplier as per the contract. The person in charge of the carrier (ship or airway) informs the officer in charge at the dock or the airport about the arrival of goods in the importing country. He provides the document called *import general manifest.* Import general manifest is a document that contains the details of the imported goods. It is a document on the basis of which unloading of cargo takes place.

(x) Customs clearance and release of goods: All the goods imported into India have to pass through customs clearance after they cross the Indian borders. Customs clearance is a somewhat tedious process and calls for completing a number of formalities. It is, therefore, advised that importers appoint C&F agents who are well- versed with such formalities and play an important role in getting the goods customs cleared.

Firstly, the importer has to obtain a *delivery order* which is otherwise known as endorsement for delivery. Generally when the ship arrives at the port, the importer obtains the endorsement on the back of the bill of lading. This endorsement is done by the concerned shipping company. In some cases instead of endorsing the bill, the shipping company issues a delivery order. This order entitles the importer to take the delivery of goods. Of course, the importer has to first pay the freight charges (if these have not been paid by the exporter) before he or she can take possession of the goods.

The importer has to also pay dock dues and obtain *port trust dues receipt*. For this, the importer has to submit to the 'Landing and Shipping Dues Office' two copies of a duly filled in form — known as 'application to import'. The 'Landing and Shipping Dues Office' levies a charge for services of dock authorities which has to be borne by the importer. After payment of dock charges, the importer is given back one copy of the application as a receipt. This receipt is known as 'port trust dues receipt'.

The importer then fills in a form *'bill of entry'* for assessment of customs import duty. One appraiser examines the document carefully and gives the examination order. The importer procures the said document prepared by the appraiser and pays the duty, if any.

After payment of the import duty, the bill of entry has to be presented to the dock superintendent. The same has to be marked by the superintendent and an examiner will be asked to physically examine the goods imported. The examiner gives his report on the bill of entry. The importer or his agent presents the bill of entry to the port authority. After receiving necessary charges, the port authority issues the release order.

Major Documents used in an Import Transaction

Trade enquiry: A trade enquiry is a written request by an importing firm to the exporter for supply of information regarding the price and various terms and conditions on which the latter exports goods.

Proforma invoice: A proforma invoice is a document that contains details as to the quality, grade, design, size, weight and price of the export product, and the terms and conditions on which their export will take place.

Import order or indent: It is a document in which the buyer (importer) orders for supply of requisite goods to the supplier (exporter). The order or indent contains the information such as quantity and quality of goods to be imported, price to be charged, method of forwarding the goods, nature of packing, mode of payment, etc.

Letter of credit: It is document that contains a guarantee from the importer bank to the exporter's bank that it is undertaking to honour the payment up to a certain amount of the bills issued by the exporter for exports of the goods to the importer.

Shipment advice: The shipment advice is a document that the exporter sends to the importer informing him that the shipment of goods has been made. Shipment of advice contains invoice number, bill of lading/airways bill number and date, name of the vessel with date, the port of export, description of goods and quantity, and the date of sailing of the vessel.

Bill of lading: It is a document prepared and signed by the master of the ship acknowledging the receipt of goods on board. It contains terms and conditions on which the goods are to be taken to the port of destination.

Airway Bill: Like a bill of lading, an airway bill is a document wherein an airline/ shipping company gives its official receipt of the goods on board its aircraft and at the same time gives an undertaking to carry them to the port of destination. It is also a document of title to the goods and as such is freely transferable by the endorsement and delivery.

Bill of entry: Bill of entry is a form supplied by the customs office to the importer. It is to be filled in by the importer at the time of receiving the goods. It has to be in triplicate and is to be submitted to the customs office. The bill of entry contains information such as name and address of the importer, name of the ship, number of packages, marks on the package, description of goods, quantity and value of goods, name and address of the exporter, port of destination, and customs duty payable.

Bill of exchange: It is a written instrument whereby the person issuing the instrument directs the other party to pay a specified amount to a certain person or the bearer of the instrument. In the context of an export-import transaction, bill of exchange is drawn by the exporter on the importer asking the latter to pay a certain amount to a certain person or the bearer of the bill of exchange. The documents giving title to the export consignment are passed on to the importer only when the importer accepts the order contained in the bill of exchange.

Sight draft: It is a type of bill of exchange wherein the drawer of the bill of exchange instructs the bank to hand over the relevant documents to the importer only against payment.

Usance draft: It is a type of bill of exchange wherein the drawer of the bill of exchange instructs the bank to hand over the relevant documents to the importer only against acceptance of the bill of exchange.

Import general manifest. Import general manifest is a document that contains the details of the imported good. It is the document on the basis of which unloading of cargo takes place.

Dock challan: Dock charges are to be paid when all the formalities of the customs are completed. While paying the dock dues, the importer or his clearing agent specifies the amount of dock dues in a *challan* or form which is known as dock *challan*.

11.4 Foreign Trade Promotion: Incentives and Organisational Support

Various incentives and schemes are operational in the country to help business firms improve competitiveness of their exports. From time-to-time, the government has also setup a number of organisations to provide infra-structural support and marketing assistance to firms engaged in international business. Major foreign trade promotion schemes and organisations are discussed in the following sections.

11.4.1 Foreign Trade Promotion Measures and Schemes

Details of various trade promotion measures and schemes available to business firms to facilitate their export and import operations are announced by the government in its export-import (EXIM) policy. Major trade promotion measures (especially those related to exports) are as follows:

(i) Duty drawback scheme: Since goods meant for exports are not consumed domestically, these are not subjected to payment of various excise and customs duties. Any such duties paid on export goods are, therefore, refunded to exporters on production of proof of exports of these goods to the concerned authorities. Such refunds are called duty draw backs. Some major duty draw backs include refund of excise duties paid on goods meant for exports, refund of customs duties paid on raw materials and machines imported for export production. The latter is also called customs drawback.

(ii) Export manufacturing under bond scheme: This facility entitles firms to produce goods without payment of excise and other duties. The firms desirous of availing such facility have to give an undertaking (i.e., bond) that they are manufacturing goods for export purposes and will export such products on their production.

(iii) Exemption from payment of sales taxes: Goods meant for export purposes are not subject to sales tax. Even for a long time, income derived from export operations had been exempt from payment of income tax. Now this benefit of exemption from income tax is available only to 100 per cent Export Oriented Units (100 per cent EOUs) and units set up in Export Processing Zones (EPZs)/Special Economic Zones (SEZs) for select years. We shall shortly discuss about the 100 per cent Export Oriented Units (100 per cent EOUs) and units set up in Export Processing Zones (EPZs)/Special Economic Zones (SEZs) in the succeeding paragraphs.

(iv) Advance licence scheme: It is a scheme under which an exporter is allowed duty free supply of domestic as well as imported inputs required for the manufacture of export goods. As such the exporter is not required to pay customs duty on goods imported for use in the manufacture of export goods. The advance licences are available to both the types of exporters — those who export on a regular basis and also to those who export on an adhoc basis. The regular exporters can avail such licences against their production programmes. The firms exporting intermittently can also obtain these licences against specific export orders.

(v) Export Promotion Capital Goods Scheme (EPCG): The main objective of this scheme is to encourage the import of capital goods for export production. This scheme allows export firms to import capital goods at negligible or lower rates of customs duties subject to actual user condition and fulfilment of specified export obligations. If the said conditions are fulfilled by the manufacturers, then they can import the capital goods either at zero or concessional rate of import duty. Supporting manufacturers and service providers are also eligible to import capital goods under this scheme. This scheme is especially beneficial to the industrial units interested in modernisation and upgradation of their existing plant and machinery. Now service export firms can also avail of this facility for importing items such as computer software systems required for developing softwares for purposes of exports.

(vi) Scheme of recognising export firms as export house, trading house and superstar trading house: With an objective to promote established exporters and assist them in marketing their products in international markets, the government grants the status of Export House, Trading House, Star Trading House to select export firms. This status is granted to a firm on its achieving a prescribed average export of performance in past select years. Besides attaining a minimum of past average export performance, such export firms have to also fulfill other conditions as laid down in the import-export policy. Various categories of export houses have been recognised with a view to building marketing infrastructure and expertise required for export promotion. These houses are given national recognition for export promotion. They are required to operate as highly professional and dynamic institutions and act as an important instrument of export growth.

(vii) Export of Services: In order to boost the export of services, various categories of service houses have been recognised. These houses are recognised on the basis of the export performance of the service providers. They are referred to as Service Export House, International Service Export House, International Star Service Export House based on their export performance.

(viii) Export finance: Exporters require finance for the manufacture of goods. Finance is also needed after the shipment of the goods because it may take sometime to receive payment from the importers. Therefore, two types of export finances are made available to the exporters by authorised banks. They are termed as pre-shipment finance or packaging credit and post-shipment finance. Under the pre-shipment finance, finance is provided to an exporter for financing the purchase, processing, manufacturing or packaging of goods for export purpose. Under the post-shipment finance scheme, finance is provided to the exporter from the date of extending the credit after the shipment of goods to the export country. The finance is available at concessional rates of interest to the exporters.

(ix) Export Processing Zones (EPZs): Export Processing Zones are industrial estates, which form enclaves from the Domestic Tariff Areas (DTA). These are usually situated near seaports or airports. They are intended to provide an internationally competitive duty free environment for export production at low cost. This enables the products of EPZs to be competitive, both quality-wise and price-wise, in the international markets. These zones have been set up at various places in India which include: Kandla (Gujarat), Santa Cruz (Mumbai), Falta (West Bengal), Noida (Uttar Pradesh), Cochin (Kerala), Chennai (Tamil Nadu), and Vishakapatnam (Andhra Pradesh).

Santa Cruz zone is exclusively meant for electronic goods and gem and jewellery items. All other EPZs deal with multifarious items. Recently the EPZs have been converted to Special Economic Zones (SEZs) which are more advanced form of export processing zones. These SEZs are free from all rules and regulations governing imports and exports units except relating to labour and banking

The government has also permitted development of EPZs by private, state or joint sector. The inter-ministerial committee on private EPZs has already cleared proposals for setting up of private EPZs in Mumbai, Surat and Kanchipuram.

(x) 100 per cent Export Oriented Units (100 per cent EOUs): The 100 per cent Export Oriented Units scheme, introduced in early 1981, is complementary to the EPZ scheme. It adopts the same production regime, but offers a wider option in location with reference to factors like source of raw materials, ports, hinterland facilities, availability of technological skills, existence of an industrial base and the need for a larger area of land for the project. EOUs have been established with a view to generating additional production capacity for exports by providing an appropriate policy framework, flexibility of operations and incentives.

11.4.2 Organisational Support

The Government of India has also set up from time-to-time various institutions in order to facilitate the process of foreign trade in our country. Some of the important institutions are as follows:

Department of Commerce: The Department of Commerce in the Ministry of Commerce, Government of India, is the apex body responsible for the country's external trade and all matters connected with it. This may be in the form of increasing commercial relations with other countries, state trading, export promotional measures and the development, and regulation of certain export oriented industries and commodities. The Department of Commerce formulates policies in the sphere of foreign trade. It also frames the import and export policy of the country in general.

Export Promotion Councils (EPCs): Export Promotion Councils are non-profit organisations registered under the Companies Act or the Societies Registration Act, as the case may be. The basic objective of the export promotion councils is to promote and develop the country's exports of particular products falling under their jurisdiction. At present, there are 21 EPC's dealing with different commodities.

Commodity Boards: Commodity Boards are the boards which have been specially established by the Government of India for the development of production of traditional commodities and their exports. These boards are supplementary to the EPCs. The functions of commodity boards are similar to those of EPCs. At present there are seven commodity boards in India: Coffee Board, Rubber Board, Tobacco Board, Spice Board, Central Silk Board, Tea Board, and Coir Board.

Export Inspection Council (EIC): The Export Inspection Council of India was setup by the Government of India under Section 3 of the Export Quality Control and Inspection Act 1963. The council aims at sound development of export trade through quality control and pre-shipment inspection. The council is an apex body for controlling the activities related to quality control and pre-shipment inspection of commodities meant for export. Barring a few exceptions, all the commodities destined for exports must be passed by EIC.

Indian Trade Promotion Organisation (ITPO): The Indian Trade Promotion Organisation was setup on 1 January 1992 under the Companies Act 1956 by the Ministry of Commerce, Government of India. Its headquarters is in New Delhi. The ITPO was formed by merging the two erstwhile agencies viz., Trade Development Authority and Trade Fair Authority of India. ITPO is a service organisation and maintains regular and close interaction with trade, industry and Government. It serves the industry by organising trade fairs and exhibitions—both within the country and outside, It helps export firms participate in international trade fairs and exhibitions, developing exports of new items, providing support and updated commercial business information. ITPO has five regional offices at Mumbai, Bengaluru, Kolkata, Kanpur and Chennai and four international offices at Germany, Japan, UAE and USA.

Indian Institute of Foreign Trade (IIFT): The Indian Institute of Foreign Trade is an institution that was setup in 1963 by the Government of India as an autonomous body registered under the Societies Registration Act with the prime objective of professionalising the country's foreign trade management. It has recently been recognised as Deemed University. It provides training in international trade, conduct researches in areas of international business, and analysing and disseminating data relating to international trade and investments.

Indian Institute of Packaging (IIP): The Indian Institute of Packaging was set up as a national institute jointly by the Ministry of Commerce, Government of India, and the Indian Packaging Industry and allied interests in 1966. Its headquarters and principal laboratory is situated at Mumbai and three regional laboratories are located at Kolkata, Delhi and Chennai. It is a training-cum-research institute pertaining to packaging and testing. It has excellent infrastructural facilities that cater to the various needs of the package manufacturing and package user industries. It caters to the packaging needs with regard to both the domestic and export markets. It also undertakes technical consultancy, testing services on packaging developments, training and educational programmes, promotional award contests, information services and other allied activities.

State Trading Organisations: A large number of domestic firms in India found it very difficult to compete in the world market. At the same time, the existing trade channels were unsuitable for promotion of exports and bringing about diversification of trade with countries other than European countries. It was under these circumstances that the State Trading Organisation (STC) was setup in May 1956. The main objective of the STC is to stimulate trade, primarily export trade among different trading partners of the world. Later, the government set up many more organisations such as Metals and Minerals Trading Corporation (MMTC), Handloom and Handicrafts Export Corporation (HHEC).

11.5 International Trade Institutions and Trade Agreements

The First World War (1914-1919) and the Second World War (1939-45) were accompanied by massive destruction of life and property the world over. Almost all the economies of the world were adversely affected. Due to scarcity of resources, countries were not in a position to take up any reconstruction or developmental works. Even the international trade amongst nations got adversely affected because of the disruption of the world's currency system. There was no system of generally accepted exchange rate. It was at that juncture that representative of forty-four nations under the leadership of J.M. Keynes — a noted economist joined together at Bretton Woods, New Hampshire to identify measures to restore peace and normalcy in the world.

The meeting was concluded with the setting up of three international institutions, namely the International Monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD) and the International Trade Organisation (ITO). They considered these three organisations as three pillars of economic development of the world. While the World Bank was assigned with the task of reconstructing war-torn economies — especially the ones in Europe, the IMF was entrusted with the responsibility of ensuring stabilisation of exchange rates to pave way for the expansion of world trade. The main objective of the ITO as they could foresee at that time was to promote and facilitate international trade among the member countries by overcoming various restrictions and discriminations that were being practiced at that time.

The first two institutions, viz., IBRD and IMF, came into existence immediately. The idea of setting up of ITO, however, could not materialise due to stiff opposition from the United States. Instead of an organisation, what eventually emerged was an arrangement to liberalise international trade from high customs tariffs and various other types of restrictions. This arrangement came to be known as the General Agreement for Tariffs and Trade (GATT). India was one of the founding members of these three international bodies. The major objectives and functions of these three international institutions are discussed in more detail in the following sections.

11.5.1 World Bank

The International Bank for Reconstruction and Development (IBRD), commonly known as World Bank, was result of the Bretton Woods Conference. The main objectives behind setting up this international organisation were to aid the task of reconstruction of the war-affected economies of Europe and assist in the development of the underdeveloped nations of the world. For the first few years, the World Bank remained preoccupied with the task of restoring war-torn nations in Europe. Having achieved success in accomplishing this task by late 1950s, the World Bank turned its attention to the development of underdeveloped nations. It realised that by investing more and more in these countries, especially in social sectors like health and education; it could bring about the needed social and economic transformation of the developing countries. To give shape to this investment aspect in the underdeveloped nations, the International Development Association (IDA) was formed in the year 1960. The main objective underlying setting up IDA has been to provide loans on concessional terms and conditions to those countries whose per capita incomes are below a critical level. Concessional terms and conditions mean that (i) repayment period is much longer than the repayment period of IBRD, and (ii) the borrowing nation need not pay any interest on the borrowed amount. IDA, thus, provides interest-free long-term loans to the poor nations. IBRD also provides loans but these carry interest charged on commercial basis.

Over the time, additional organisations have been set up under the umbrella of the World Bank. As of today, the World Bank is a group of five international organisations responsible for providing finance to different countries. The group and its affiliates headquartered in Washington DC catering to various financial needs are listed in the Box A on World Bank and its affiliates.

11.5.2 International Monetary Fund

The International Monetary Fund (IMF) is the second international organisation next to the World Bank. IMF which came into existence in 1945 has its headquarters located in Washington DC. In 2005, it had 191 countries as its members.The major idea underlying the setting up of the IMF is to evolve an orderly international monetary system, i.e., facilitating system of international payments and adjustments in exchange rates among national currencies.

Major objectives of IMF include

- To promote international monetary cooperation through a permanent institution,
- To facilitate expansion of balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income,
- To promote exchange stability with a view to maintain orderly exchange arrangements among member countries, and
- To assist in the establishment of a multilateral system of payments in respect of current transactions between members.

Functions of IMF

Various functions are performed by the IMF to achieve the aforesaid objectives. Some of the important functions of IMF include:

- Acting as a short-term credit institution;
- Providing machinery for the orderly adjustment of exchange rates;
- Acting as a reservoir of the currencies of all the member countries, from which a borrower nation can borrow the currency of other nations;
- Acting as a lending institution of foreign currency and current transaction;
- Determining the value of a country's currency and altering it, if needed, so as to bring about an orderly adjustment of exchange rates of member countries; and
- Providing machinery for international consultations.

11.5.3 World Trade Organization (WTO) and Major Agreements

On the lines of IMF and the World Bank, it was initially decided at the Bretton Woods conference to set up the International Trade Organisation (ITO) to promote and facilitate international trade among the member countries and to overcome various restrictions and discriminations as were being practiced at that time. But the idea could not materialise due to stiff opposition from the United States. Instead of altogether abandoning the idea, the countries that were participants to the Bretton Woods conference agreed upon having some arrangement among themselves so as to liberalise the world from high customs tariffs and various other types of restrictions that were in vogue at that time. This arrangement came to be known as the General Agreement for Tariffs and Trade (GATT).

GATT came into existence with effect on 1 January 1948 and remained in force till December 1994. Various rounds of negotiations have taken place under the auspices of GATT to reduce tariff and non-tariff barriers. The last one, known as the Uruguay Round, was the most comprehensive one in terms of coverage of issues, and also the lengthiest one from the point of view of duration of negotiations which lasted over a period of seven years from 1986 to 1994.

One of the key achievements of the Uruguay Round of GATT negotiations was the decision to set up a permanent institution for looking after the promotion of free and fair trade amongst nations. Consequent to this decision, the GATT was transformed into World Trade Organization (WTO) with effect from 1 January 1995. The headquarters of the WTO are situated at Geneva, Switzerland. The establishment of WTO, thus, represents the implementation of the original proposal of setting up of the ITO as evolved almost five decades back.

Though, WTO is a successor to GATT, it is a much more powerful body than GATT. It governs trade not only in goods, but also in services and intellectual property rights. Unlike GATT, the WTO is a permanent organisation created by an international treaty ratified by the governments and legislatures of member states. It is, moreover, a member-driven rule-based organisation in the sense that all the decisions are taken by the member governments on the basis of a general consensus. As the principal international body concerned with solving trade problems between countries and providing a forum for multilateral trade negotiations, it has a global status similar to that of the IMF and the World Bank. India is a founding member of WTO. As on 11 December 2005, there were 149 members in WTO.

Objectives of WTO

The basic objectives of WTO are similar to those of GATT, i.e., raising standards of living and incomes, ensuring full employment, expanding production and trade, and optimal use of the world's resources. The major difference between the objectives of GATT and WTO is that the objectives of WTO are more specific and also extend the scope of WTO to cover trade in services. WTO objectives, moreover, talk of the idea of 'sustainable development' in relation to the optimal use of the world's resources so as to ensure protection and preservation of the environment. Keeping in view the above discussion, we can state more explicitly the following as the major objectives of WTO:

- To ensure reduction of tariffs and other trade barriers imposed by different countries;
- To engage in such activities which improve the standards of living, create employment, increase income and effective demand and facilitate higher production and trade;
- To facilitate the optimal use of the world's resources for sustainable development; and
- To promote an integrated, more viable and durable trading system.

Functions of WTO

The major functions of WTO include:

- Promoting an environment that is encouraging to its member countries to come forward to WTO in mitigating their grievances;
- Laying down a commonly accepted code of conduct with a view to reducing trade barriers, including tariffs and eliminating discriminations in international trade relations;
- Acting as a dispute settlement body;
- Ensuring that all rules regulations prescribed in the Act are duly followed by the member countries for the settlement of their disputes;
- Holding consultations with the IMF and the IBRD and its affiliated agencies so as to bring better understanding and cooperation in global economic policy making; and
- Supervising on a regular basis the operations of the revised Agreements and Ministerial declarations relating to goods, services and Trade Related Intellectual Property Rights (TRIPS).

Benefits of WTO

Since its inception in 1995, the WTO has come a long way in constituting the legal and institutional foundation of the present day multilateral trading system. It has been instrumental not only in facilitating trade, but also in improving living standards and cooperation among member countries. Some of the major benefits of WTO are as follows:

- WTO helps promote international peace and facilitates international business.
- All disputes between member nations are settled with mutual consultations.
- Rules make international trade and relations very smooth and predictable.
- Free trade improves the living standard of the people by increasing the income level.
- Free trade provides ample scope of getting varieties of qualitative products.
- Economic growth has been fastened because of free trade.
- The system encourages good government.
- WTO helps fostering growth of developing countries by providing them with special and preferential treatment in trade related matters.

Key Terms

International business	Invisible trade	Exproting	Licensing
International trade	Foreign investment	Importing	Franchising
Merchandise trade	FDI	Contract manufacturing	Outsourcing
	Portfolio investment		Joint ventures

Wholly owned subsidiaries
Proforma invoice
Order or intent
Export licence
IEC number
Registration-cum membership certificate
Pre-shipment finance
Pre-shipment inspection
Export inspection agency
Excise clearance
Certificate of origin
Customs clearance

Letter of credit
Shipping bill
Mate receipt
Bill of lading
Airway bill
Invoice
Bill of exchange
Sight draft
Usance draft
Negotiation of bills
Marine insurance policy
Cart ticket
Bank certificate of payment

Certificate of inspection
Trade enquiry
Shipment advice
Import general manifest
Delivery order
Bill of entry
C&F agent
Port trust dues receipt
Duty drawback scheme
Export manufacturing under bond scheme
Advance licence scheme
Export Promotion Capital Goods Scheme (EPCG)
Export finance
Post-shipment finance
Export processing zone (EPZ)

100% Export Oriented Unit (100% EOU)
Department of Commerce
Export promotion council
Commodity boards
IIFT
Indian Institute of Packaging
ITPO
Export Inspection Council
State trading organisations

SUMMARY

International Business: International business refers to business activities that take place across national frontiers. Though many people use the terms international business and international trade synonymously, the former is a much broader term. International business involves not only trade in goods and services, but also other operations, such as production and marketing of goods and services in foreign countries.

International Vs Domestic Business: Conducting and managing international business operations is more complex than undertaking domestic business. Differences in the nationality of parties involved, relatively less mobility of factors of production, customer heterogeneity across markets, variations in business practices and political systems, varied business regulations and policies, and use of different currencies are the key aspects that differentiate international businesses from domestic business. These, moreover, are the factors that make international business much more complex and a difficult activity.

Export Procedures: The starting point in an export transaction is the receipt of an enquiry from the overseas buyer. In response, the exporter prepares an export quotation — called proforma invoice, giving out details about the export goods and the terms and conditions of export. In case, the importer finds the quotation acceptable, he/she places an order or indent and gets a letter of credit issued from his/her bank to the exporter. The exporter then proceeds with the formalities related to obtaining an export licence from the Director General of Foreign Trade and getting a registration-cum-membership certificate from the export promotion council looking after the export of the concerned product. In case, the exporter requires funds, he/she can avail of pre-shipment finance from a bank. The exporter then proceeds with the production or procurement of the goods and gets them inspected from Export Inspection Council. If required by the importer, the exporter approaches the foreign consulate for obtaining the certificate of origin to enable the importer to claim tariff of quota concessions at the time of clearance of cargo at the import destination. The exporter, then, makes arrangement, for reserving space on the ship and insuring goods against transit perils. After obtaining the excise clearance, goods are sent to the concerned port for customs clearance. Since customs clearance is a tedious process, exporters often employ C&F agents for availing their services in preparation of various customs documents and getting the goods customs cleared.

After customs clearance and payment of dock charges to the port authorities and freight charges to the shipping company, goods are loaded on the ship. The captain of the ship issues a mate's receipt. This mate's receipt is submitted to the shipping company's office for the payment of freight. After receiving the freight charges, the shipping company issues a bill of lading, which is a document of contract relating to shipment of the goods by the shipping company. Once the goods are dispatched, the exporter prepares an invoice and sends the necessary documents, such as certified copy of invoice, bill of lading, packing list, insurance policy, certificate of origin, letter of credit and bill of exchange to the importer through his/her bank to release a certificate of payment. Certificate of payment is a document that certifies that the export transaction is over and the payment has been received.

Import Procedure: The procedure to import is also beset with several formalities. The process starts with a search for export firms and making a trade enquiry about the product, its price and terms and conditions of exports. Having selected an export firm, the importer asks the exporter to send him/her a formal quotation called proforma invoice. The importer, then, proceeds to obtain the import licence, if required, from the office of the Directorate General Foreign Trade (DGFT) or Regional Import Export Licensing Authority. The importer also applies for the Import Export Code (IEC) number. This number is required to be mentioned on most of the import documents. Since payment for imports requires foreign currency, the importer has to send an application to a bank authorised for sanction of the necessary foreign exchange.

After obtaining an import licence, the importer places an import order or indent with the exporter for supply of the specified products. If required as per the terms of contract, the importer arranges for the issuance of a letter of credit to the exporter from the bank. Having shipped the goods under shipment advice to the importer, the exporter sends a set of necessary documents containing bill of exchange, commercial invoice, bill of lading/airway bill, packing list, certificate of origin, marine insurance policy, etc., to enable the importer claim title to the goods on their arrival at the port of destination. The exporter sends these documents through his/her bank to the importer. The bank presents these documents to the importer and after obtaining his/her acceptance of the bill of exchange, delivers the documents to the importer.

After the arrival of the goods in the importing country, the person in charge of the carrier (ship or airway) prepares import general manifest to inform the officer in charge at the dock or the airport that the goods have reached the ports of the importing country. The importer or his/her C&F agent pays the freight (if not already paid by exporter) to the shipping company and obtains delivery order from it which entities the importer to take the delivery of the goods at the port. At this time, port dock dues are also paid and a port trust dues receipt is obtained. The importer, then, fills in a form *'bill of entry'* for assessment of customs import duty. After the payment of the import duty, the bill of entry has to be presented to the dock superintendent for physical examination of the goods. The examiner gives his report on the bill of entry. The importer or his agent presents the bill of entry to the port authority for issuance of the release order.

EXERCISES

Multiple Choice Questions

1. In which of the following modes of entry, does the domestic manufacturer give the right to use intellectual property, such as patent and trademark to a manufacturer in a foreign country for a fee:
   a. Licensing
   b. Contract manufacturing
   c. Joint venture
   d. Public Private Partnership
2. When two or more firms come together to create a new business entity that is legally separate and distinct from its parents it is known as:
   a. Contract manufacturing
   b. Franchising
   c. Joint venture
   d. Licensing
3. Which of the following is not an advantage of exporting?
   a. Easier way to enter into international markets
   b. Comparatively lower risks
   c. Limited presence in foreign markets
   d. Less investment requirements
4. Which one of the following modes of entry permits the greatest degree of control over overseas operations?
   a. Licensing/franchising
   b. Wholly owned subsidiary
   c. Contract manufacturing
   d. Joint venture

5. Which one of the following is not amongst India's major export items?

   a. Textiles and garments
   b. Gems and jewellery
   c. Oil and petroleum products
   d. Basmati rice

6. Which one of the following is not amongst India's major import items?

   a. Ayurvedic medicines
   b. Oil and petroleum products
   c. Pearls and precious stones
   d. Machinery

7. Which of the following documents are not required for obtaining an export licence?

   a. IEC number
   b. Letter of credit
   c. Registration-cum-membership certificate
   d. Bank account number

8. Which of the following documents is not required in connection with an import transaction?

   a. Bill of lading
   b. Shipping bill
   c. Certificate of origin
   d. Shipment advice

9. Which of the following do not form part of duty drawback scheme?

   a. Refund of excise duties
   b. Refund of customs duties
   c. Refund of export duties
   d. Refund of income dock charges at the port of shipment

10. Which one of the following is not a part of export documents?

    a. Commercial invoice
    b. Certificate of origin
    c. Bill of entry
    d. Mate's receipt

11. A receipt issued by the commanding officer of the ship when the cargo is loaded on the ship is known as:

    a. Shipping receipt
    b. Mate receipt
    c. Cargo receipt
    d. Charter receipt

12. Which of the following document is prepared by the exporter and includes details of the cargo in terms of the shipper's name, the number of packages, the shipping bill, port of destination and name of the vehicle carrying the cargo?

    a. Shipping bill
    b. Packaging list
    c. Mate's receipt
    d. Bill of exchange

13. The document containing the guarantee of a bank of honour drafts drawn on it by an exporter is:
    a. Letter of hypothecation
    b. Letter of credit
    c. Bill of lading
    d. Bill of exchange

14. TRIP is one of the WTO agreements that deal with:
    a. Trade in agriculture
    b. Trade in services
    c. Trade related investment measures
    d. None of these

Short Answer Questions

1. Differentiate between international trade and international business.
2. Discuss any three advantages of international business.
3. What is the major reason underlying trade between nations?
4. Why is it said that licensing is an easier way to expand globally?
5. Differentiate between contract manufacturing and setting up wholly owned production subsidiary abroad.
6. Discuss the formalities involved in getting an export licence.
7. Why is it necessary to get registered with an export promotion council?
8. Why is it necessary for an export firm to go in for pre-shipment inspection?
9. What is bill of lading? How does it differ from bill of entry?
10. Explain the meaning of mate's receipt.
11. What is a letter of credit? Why does an exporter need this document?
12. Discuss the process involved in securing payment for exports.

Long Answer Questions

1. "International business is more than international trade". Comment.
2. What benefits do firms derive by entering into international business?
3. In what ways is exporting a better way of entering international markets than setting up wholly owned subsidiaries abroad.
4. Rekha Garments has received an order to export 2000 men's trousers to Swift Imports Ltd., located in Australia. Discuss the procedure that Rekha Garments would need to go through for executing the export order.
5. Your firm is planning to import textile machinery from Canada. Describe the procedure involved in importing.

6. Identify various organisations that have been set up in the country by the government for promoting country's foreign trade.
7. What is IMF? Discuss its various objectives and functions.
8. Write a detailed note on features, structure, objectives and functioning of WTO.

I Project/Assignment — India In the World Trade

Carefully read the given data. This pertains to India's performance in world trade. The recent initiatives of the Government of India, such as 'Make in India', 'Digital India', 'Skill India' and roll out of the Foreign Trade Policy (FTP) 2015-20 has impacted the Indian economy in terms of exports and imports and trade balance.

1. Table 1 shows India's position in the world's largest economies. Prepare a trend report on the position of India in the global scenario of international trade from the year 2005-2017.
2. Table presents the data about major trade partners of India in the global trade.

   Discuss how business and trade activities help in promoting peace and harmony among nations.
3. Graphically represent (Line Graph or Bar Graph) the status of export and import from the year 2006-2007 to the year 2016-2017 as given in Table 3.

Table 1

S.No.	Country	% share in global trade
1.	United States	24.3
2.	China	14.8
3.	Japan	5.9
4.	Germany	4.5
5.	United Kingdom	3.9
6.	France	3.3
7.	India	2.8
8.	Italy	2.5
9.	Brazil	2.4
10.	Canada	2.1

Source: *World Bank, 2017*

Table 2

India's trading partners with total trade (2014-15)					(figures in US $)
S.No.	**Country**	**Exports**	**Imports**	**Total Trade**	**Trade Balance**
1.	China	9.01	61.71	70.72	(52.70)
2.	United States	40.34	62.12	62.12	(18.55)
3.	UAE	30.29	49.74	49.74	(10.84)
4.	Saudi Arabia	6.39	20.32	26.72	(13.93)
5.	Germany	.98	12,09	20.33	(5.25)
6.	South Korea	3.52	13.05	18.13	(8.93)
7.	Malaysia	3.71	9.08	16.93	(5.30)
8.	Singapore	7.72	7.31	16.93	(2.68)
9.	Nigeria	2.22	9.95	16.36	(11.00)
10.	Belgium	5.03	8.26	16.33	(5.29)
11.	Qatar	.90	9.02	15.66	(13.55)
12.	Japan	4.66	9.85	15.52	(4.75)
13.	United Kingdom	8.83	5.19	14.34	(4.30)
					Selected countries only.

Table 3

Year	**Merchandise**		
	Export	**Import**	**Trade Balance**
2006-2007	571779	840506	(268727)
2007-2008	655864	1012312	(356448)
2008-2009	840755	1374438	(533680)
2009-2010	845534	1363736	(518202)
2010-2011	1136954	1683487	(546503)
2011-2012	1465959	2345463	(879504)
2012-2013	1634318	2669162	(1034844)
2013-2014	1905011	2715434	(810423)
2014-2015	1896348	2737087	(840738)
2015-2016(P)	1716378	2490298	(773920)
2016-2017 (P) till October	1039797	1396352	(356554)
Annual report, 2016-17, Ministry of Commerce			

4. Growth rate in Exports and Imports

Table 4

Year		
	Export Growth %	**Import Growth %**
2006-2007	25.28	27.27
2007-2008	14.71	20.44
2008-2009	28.19	35.77
2009-2010	0.57	(0.78)
2010-2011	34.47	23.45
2011-2012	28.94	39.32
2012-2013	11.48	13.8
2013-2014	16.58	1.73
2014-2015	(0.45)	0.8
2015-2016(P)	(6.49)	(9.02)
2016-2017 (P) till October	4.17	(6.99)
Annual report, 2016-17, Ministry of Commerce		

5. Table 5 provides the selected principal commodities, in which India deals at the global level. Prepare a pie-chart of any five commodities of your choice from the given data. You can also go through annual report 2016-2017 of the Ministry of Commerce and choose commodities other than those given in the Table.

Table 5

S. No.	**Commodity**	**Year**	**Export (US $)**	**% Share (US $)**	**Import**	**% Share**
1.	Plantation	2014-2015 2015-2016 2016-2017 (P) (April-October, 2017)	1503 1563 895	1034 895 524	.58	0.25
2.	Agriculture and Allied Products	2014-2015 2015-2016 2016-2017 (P) (April-October, 2017)	30147 24522 13420	19004 20673 12189	8.64	5.84
3.	Ores and Minerals	2014-2015 2015-2016 2016-2017 (P) (April-October, 2017)	2410 2015 1412	26918 20684 12941	.91	5.08

4.	Leather and Leather Manufactures	2014-2015 2015-2016 2016-2017 (P) (April-October, 2017)	6195 5554 3158	2.03	1093 1031 606	0.28
5.	Gems and Jewellery	2014-2015 2015-2016 2016-2017 (P) (April-October, 2017)	41266 39283 26458	17.02	62351 56509 33845	12.80
6.	Chemicals and Related Products	2014-2015 2015-2016 2016-2017 (P) (April-October, 2017)	31731 32169 18740.56	12.06	31731 32169 18740	12.06
7.	Plastic and Rubber	2014-2015 2015-2016 2016-2017 (P) (April-October, 2017)	6615 6416 3683	2.32	6615 6416 3682	2.37
8.	Electronic Items	2014-2015 2015-2016 2016-2017 (P) (April-October, 2017)	6009 5690 3270	2.10	6009 5690 3270	2.10
9.	Textile and Allied Products	2014-2015 2015-2016 2016-2017 (P) (April-October, 2017)	37141 35953 19593	12.61	37141 35953 19594	12.61
10.	Petroleum Crude and Products	2014-2015 2015-2016 2016-2017 (P)(April-October, 2017)	56794 30583 19597	11.32	56794 30583 19597	11.32

II Recall Section I of Chapter 1. Discuss in the class the position of exports and imports in ancient times and compare the status of international trade in today's scenario.

III Discuss the benefits of "Make in India" scheme of Government of India in the promotion of internal and external trade of India.

FORM NO. INC-1

(Pursuant to section 4(4) of the Companies Act, 2013 and pursuant to rule 8 & 9 of the Companies (Incorporation) Rules, 2014)

Application for reservation of Name

Form language ⦿ English ○ Hindi

Refer the instruction kit for filing the form.

1.* Application for :
- ○ Incorporating a new company (Part A, B, C)
- ○ Changing the name of an existing company (Part B, C, D)

Part A: Reservation of name for incorporation of a new company

2. Details of applicant (In case the applicant has been allotted DIN, then it is mandatory to enter such DIN)

(a) Director identification number (DIN) or Income tax permanent account number (PAN) or passport number [ ] Pre-fill | Verify Details

(b) *First Name [ ]

Middle Name [ ]

*Surname [ ]

(c) *Occupation Type ○ Self-employed ○ Professional ○ Homemaker ○ Student ○ Serviceman

(d) Address *LINE I [ ]

LINE II [ ]

(e) *City [ ]

(f) *State/Union Territory [ ]

(g) *Pin Code [ ]

(h) ISO Country code [ ]

(i) Country [ ]

(j) e-mail ID [ ]

(k) Phone (with STD/ISD code) [ ] — [ ]

(l) Mobile (with country code) [ ] — [ ]

(m) Fax [ ] — [ ]

3. (a) *Type of company
- ○ Section 8 company ○ Part I company (Chapter XXI) ○ Producer company
- ○ New company (others)

(d) *State the sub-category of proposed company
- ○ Public ○ Private ○ Private (One Person Company)

(b) *State class of the proposed company [ ]

(c) *State the category of proposed company [ ]

4. *Name of the State/Union territory in which the proposed company is to be registered

[ ]

5. *Name of the office of the Registrar of Companies in which the proposed company is to be registered

6. Details of promoter(s) (In case the promoter(s) has been allotted DIN, then it is mandatory to enter such DIN)

   * Enter the number of promoter(s)

*Category

DIN or Income-tax PAN or passport number or corporate identification number (CIN) or foreign company registration Number (FCRN) or any other registration number — Pre-fill

*Name

7. *Objects of the proposed Company to be included in its MoA

8. *Particulars of proposed director(s)

   (Specify information of one director in case the proposed company is One Person Company or of two directors in case the proposed company is a private company (other than producer company) or of three directors in case the proposed company is a public company or of five directors in case the proposed company is a producer company)

*Director Identification Number (DIN) — Pre-fill

Name

Father's Name

Nationality — Date of birth (DD/MM/YY)

Income tax permanent account number (PAN)

Passport number — Voter identity card number

Aadhaar number

Present residential address

9 *Whether the Promoters are carrying on any Partnership firm, sole proprietary or unregistered entity in the name as applied for

   ○ Yes ○ No

   (If yes, attach NOC from all owners/partners of such entity for use of such name)

Part B. Particulars about the proposed name(s)

10. *Number of proposed names for the company

   (Please give maximum six names in order of preference)

I.		
	Proposed name	
	Significance of key or coined word in the proposed name	
	State the name of the vernacular language(s) if used in the proposed name	

11. *Whether the proposed name is in resemblance with any class of Trade Marks Rules, 2002
   ○ Yes ○ No
   If yes, Please specify the Class(s) of trade mark
12. *Whether the proposed name(s) is/are based on a registered trade mark or is subject matter of an application pending for registration under the Trade Marks Act.
   ○ Yes ○ No
   If yes, furnish particulars of trade mark or application and the approval of the applicant or owner of the trademark
13. In case the name is similar to any existing company or to the foreign holding company, specify name of such company and also attach copy of the No Objection Certificate by way of board resolution (Duly attested by a director of that company)
   (a) Whether the name is similar to holding Company
   ○ Existing Company ○ Foreign holding company
   (b) In case of existing Company, provide CIN Pre-fill
   (c) Name of the Company
14. (a) Whether the proposed name includes the words such as Insurance, Bank, Stock exchange, Venture Capital, Asset Management, Nidhi, or Mutual Fund etc. ○ Yes ○ No
   If Yes, whether the in-principle approval is received from
   specify other ○ Yes ○ No
   (If yes, attach the approval or if No, attach the approval at the time of filing the incorporation form
   (b) *Whether the proposed name including the phrase 'Electoral trust' ○ Yes ○ No
   [If Yes, attach the affidavit as per rule 8(2)(b)(vi)]

Part C. Names requiring Central Government approval

15. *State whether the proposed name(s) contain such word or expression for which the previous approval of Central Government is required ○ Yes ○ No
   (If Yes, this form shall be treated as an application to the Central Govt., for such approval and shall be dealt with accordingly)

Part D. Reservation of name for change of Name by an Existing Company

16. (a) *CIN of Company Pre-fill
   (b) Global Location Number (GLN) of Company
17. (a) Name of Company
   (b) Address of the registered office of the Company
   (c) Email ID of the Company
18. (a) * State whether the change of name is due to direction received from the Central Government.
   ○ Yes ○ No
   (If yes, please attach a copy of such directions)

(b) * Whether the proposed name is in accordance with the rule 8(8) and specific direction of the Tribunal is attached.

○ Yes ○ No

[If 'Yes' selected,attach order of tribunal as required in Rule 8(8)]

19. (a) Whether the change in name requires change in object of the company

○ Yes ○ No

(b) Reasons for change in name (in case of yes above, mention proposed object of the company)

Attachments

(12) Optional attachment, if any. Attach List of attachments

Remove attachment

Declaration

☐ *I have gone through the provisions of The Companies Act, 2013, the rules thereunder and prescribed guidelines framed thereunder in respect of reservation of name, understood the meaning thereof and the proposed name(s) is/are in conformity thereof.

☐ *I have used the search facilities available on the portal of the Ministry of Corporate Affairs (MCA) for checking the resemblance of the proposed name(s) with the companies and Limited Liability partnerships (LLPs) respectively already registered or the names already approved. I have also used the search facility for checking the resemblances of the proposed name(s) with registered trademarks and trade mark subject of an application under The Trade Marks Act, 1999 and other relevant search for checking the resemblance of the proposed name(s) to satisfy myself with the compliance of the provisions of the Act for resemblance of name and Rules thereof.

☐ *The proposed name(s) is/are not in violation of the provisions of Emblems and Names (Prevention of Improper Use) Act, 1950 as amended from time to time.

☐ *The proposed name is not offensive to any section of people, e.g., proposed name does not contain profanity or words or phrases that are generally considered a slur against an ethnic group, religion, gender or heredity.

☐ *The proposed name(s) is not such that its use by the company will constitute an offence under any law for the time being in force.

☐ *To the best of my knowledge and belief, the information given in this application and its attachments thereto is correct and complete, and nothing relevant to this form has been suppressed.

☐ *I undertake to be fully responsible for the consequences in case the name is subsequently found to be in contravention of the provisions of section 4(2) and section 4(4) of the Companies Act, 2013 and rules thereto and I have also gone through and understood the provisions of section 4(5) (ii) (a) and (b) of the Companies Act, 2013 and rules thereunder and fully declare myself responsible for the consequences thereof.

To be digitally signed by

*Designation

*DIN or Income-tax PAN or passport number of the applicant or Director identification number of the director; or PAN of the manager or CEO or CFO; or Membership number of the Company Secretary

Note: Attention is drawn to the provisions of Section 7(5) and 7(6) which, inter-alia, provides that furnishing of any false or incorrect particulars of any information or suppression of any material information shall attract punishment for fraud under Section 447. Attention is also drawn to provisions of Section 448 and 449 which provide for punishment for false statement and punishment for false evidence respectively.

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