SATHYABAMA

INSTITUTE OF SCIENCE AND TECHNOLOGY

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**SCHOOL OF MANAGEMENT STUDIES**

# UNIT I - BUSINESS ORGANISATION – SBAA 1104

Meaning and definition of business

Business denotes **busi-ness**, that is the state of being busy – any activity in which one keeps himself busy. But the economic term of business refers to work, efforts, and acts of people or human busy in connection with the production of wealth. Business is the sum of total activities which are connected with the production or purchase and sale of goods and services with the main objective to earn profit.

According to Urwick and Hunt, **"Business is any enterprise which makes, distributes or provides any service which other members of the community need and are willing to pay for it".**

**Nature of Business**

Man always wants and wants more. In fact he is a wanting being having insatiable innumerous wants. For satisfying his wants he works and works harder so as to make use of scarce resources available. Making use of scarce resources to the best advantage for the satisfaction of human wants is termed as economic activity. Economic activities, thus deal with the activities of living and making a living. For this purpose everyone of use follow an occupation according to our inkling, capacity, knowledge and training. One therefore, may either follow a profession (rendering specialized expert and personal service), or seek employment (under taking to work for others according to terms and conditions set for the purpose), or set up a business engaging in production of wealth.

Business is an economic activity having some feature and characteristics. Following are some important characteristics of Business

**1. Production or Acquisition of Goods**

Every business whether small or large scale deals with goods and services. The goods may produce, manufacture or procure. Business is either to produce, manufacture or procure and then to supply for a price to those who are in need of the goods so produced, manufactured or procured.

**2. Profit – The basic motive of business**

Profit is an essential part of business; in fact **profit** is the motivation factor behind a business one carries on. Profit is stimulus and a guarantee to continue the business. Profit is the factor which ensures the survival of the business. Profit is the reward of all those individuals engaged in a particular business. The efficiency of a businessman depends on the profit which he is able to make during the business operation. He renders singular service to the continuity by satisfying the needs of the people. He expected a reward for such a service rendered and if he gets the double and redoubles his efforts and plans his future in such manner so as to render best possible service to the **community**.

**3. Risk – Uncertainty of future**

Every business involves risk and uncertainty while carrying on its operations. Future is uncertain and business activity focuses on future. This focus on future and uncertainty of future naturally entails risk. It is risk which every businessman takes when he embarks upon a business activity.

**4. Dealing in Goods and Services**

Business refers to goods and services dealt with a view to supply to those who need them and are ready to make payment for the same. Dealing in goods and services is business. The goods may either be consumers' goods (Cloth, books, electronics appliances, medicine etc) or Producer goods (machinery, tools etc) or services (courier or transport services etc).

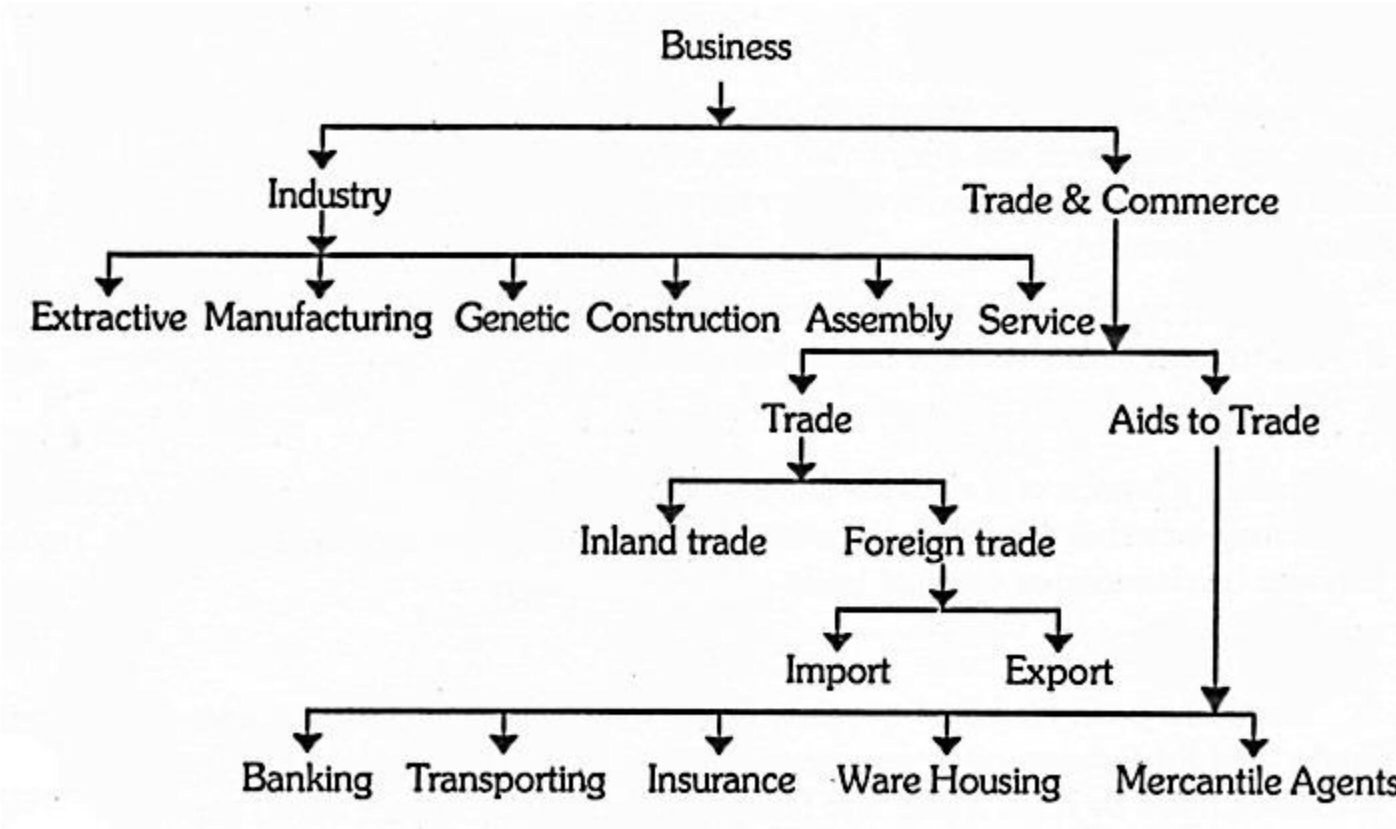
**5. Regular Dealings**

One of important characteristics of business is regularity and recurrences. Business is not a single operation. A single operation would never constitute a business. It should a regular and continuous entity. Recurrence of dealing is a must to constitute a business. On selling furniture of his household with a view to replace it with new one is not business. But if the same person procures a variety of furniture, keeps the stock and sells them to the consumers, he carries on a business dealing in furniture.

Scope of Business

The Scope of "Business" is wider than that of the terms **"Trade" and "Commerce".** The terms trade and commerce are often used synonymously.

Trade is one of the branches of commerce. It is concerned with exchange of goods and services. It performs the function of acting as an intermediary and thereby it transfers goods from the producer to the consumer. On the other hand, commerce is a wider term. It includes "Trade" as well as, Aids to trade i.e. the various activities which facilitate trade.




**Scope of Business**

1. **Industry**

The word "Industry" refers to that part of business activities which is apprehensive with the extraction, production or fabrication of products. The products which are raised, produced or processed by an industry may either be used by the ultimate consumer or by another concern for further production. If the goods produced by an industry are consumed by the final customers, these are named as 'consumer's goods' e.g. clothes. If the goods are used for further production of wealth they are called producer's or capital goods. In case the goods produced by an industry are further processed into finished products by another concern they are called as intermediate goods. i.e Plastic.

**Types of Industry**

On the basis activity industry is further classified into various types are as under:-

**(i) Extractive Industries**

Extractive industries are those industries which extract, raise or fabricate raw materials from above or beneath surface of the earth. i.e. Mining, fisheries forestry, agriculture.

**(ii) Genetic Industries**

Those industries which are engaged in reproducing and multiplying certain species of animals and plants and selling them in the market for profit are named as genetic industries. i.e. Cattle breeding farms, poultry farms, plant nurseries.

**(iii) Constructive Industries**

Constructive industries as the name signifies are engaged in the construction of building, canals, brides, dams, roads etc.

**(iv) Manufacturing Industries**

Manufacturing industries are those which are concerned of converting raw material or semi finished products into finished products. E.g. Shoes Company, Textiles Mills.

**(v) Service Industries**

Service industries are usually engaged in the manufacturing of intangible goods which cannot be seen or touched by naked eye. The service of professionals such as doctors, lawyers is examples of service industries.

**(vi) Commerce**

The second element that comes in the scope of business is Commerce. It is a very important component of business and is concerned with the buying and selling of goods. It includes all the activities which are connected to the transfer of goods from the place of production to the ultimate consumers. The whole ranges of commerce activities are classified are as under:-

2. **Trade**

The process of buying and selling of goods is called Trade. It is the exchange of goods and services among buyers and sellers in which both the parties are benefited. Trade is classified into two types.

**(i) Internal Trade**

The process of buying and selling of goods within the edge of a country is called internal trade.

- **Wholesale Trade.** The process of purchase of goods in huge quantity from producers and their resale to retailers is known as wholesale trade. The retailer then further sells these goods to the final consumers.
- **Retail Trade.** The retailer sale the goods and services to the ultimate consumers is known as Retail Trade.

**(ii) External Trade**

The purchase and sale of goods between two countries are called external trade. It is also called foreign trade. There are two types of external Trade.

- Import Trade
- Export Trade.

3. **Aid to Trade**

The activities which help in the purchase of goods and services are called aids to trade. The aids which are compulsory for the development of the trade are as follows:-

**(i) Transport**

The different ways of transport help in carrying goods from the places of production to centers of utilization e.g. Railways, ships, airlines etc.

**(ii) Insurance**

Insurance is very essential aid to trade. The risk of damage of goods due to fire, flood, earthquake or other causes us covered by insurance.

**(iii) Warehousing**

Warehousing is a kind of storeroom. Nowadays most of the goods are produce in anticipation of demand. They are stored in safe places and are released as and when demanded in the market. Warehousing thus helps in overcoming the barrier of time and creates time utility.

**(iv) Banking**

The commercial banks play a vital role in financing the different trade activities. They are funding the traders for stock holding and transportation of goods. They also support the buyers and sellers of goods in receiving and making payments, both at the national and worldwide level. The credit facility in the form of cash credit, overdrafts and loans is provided to the traders.

**(v) Advertisement**

Selling of goods is the most difficult problem for the producer. Advertisement regarding the product through newspapers, magazines, radio and television has greatly helped the consumers in choosing the goods of their taste. So advertisements play a vital role in increasing sale of goods.

Meaning, Definition of Business Organisation

**An entrepreneur** organizes various factors of production like land, labour, capital, machinery, etc. for channelizing them into productive activities. The product finally reaches consumers through various agencies. Business activities are divided into various functions, these functions are assigned to different individuals.

Various individual efforts must lead to the achievement of common business goals. Organization is the structural framework of duties and responsibilities required of personnel in performing various functions with a view to achieve business goals through organization. Management tries to combine various business activities to accomplish predetermined goals.

Present business system is very complex. The unit must be run efficiently to stay in the competitive world of business. Various jobs are to be performed by persons most suitable for them. First of all various activities should be grouped into different functions. The authority and responsibility is fixed at various levels. All efforts should be made to co-ordinate different activities for running the units efficiently so that cost of production may be reduced and profitability of the unit may be increased.

Definitions:

Louis Allen, "Organization is the process of identifying and grouping work to be performed, defining and delegating responsibility and authority and establishing relationships for the purpose of enabling people to work most effectively together in accomplishing objectives." In the words of Allen, organization is an instrument for achieving organizational goals. The work of each and every person is defined and authority and responsibility is fixed for accomplishing the same.

Wheeler, "Internal organization is the structural framework of duties and responsibilities required of personnel in performing various functions within the company. It is essentially a blue print for action resulting in a mechanism for carrying out function to achieve the goals set up by company management". In Wheeler's view, organization is a process of fixing duties and responsibilities of persons in an enterprise so that business goals are achieved.

Koontz and O'Donnell, 'The establishment of authority relationships with provision for co-ordination between them, both vertically and horizontally in the enterprise structure." These authors view organization as a coordinating point among various persons in the business.

Oliver Sheldon, "Organization is the process so combining the work which individuals or groups have to perform with the facilities necessary for its execution, that the duties so performed provide the best channels for the efficient, systematic, positive and coordinated application of the available effort". Organization helps in efficient utilization of resources by dividing the duties of various persons.

Characteristics of Business Organisation

1. Economic activity:

Business is an economic activity of production and distribution of goods and services. It provides employment opportunities in different sectors like banking, insurance, transport, industries, trade etc. it is an economic activity corned with creation of utilities for the satisfaction of human wants.

It provides a source of income to the society. Business results into generation of employment opportunities thereby leading to growth of the economy. It brings about industrial and economic development of the country.

2. Buying and Selling:

The basic activity of any business is trading. The business involves buying of raw material, plants and machinery, stationary, property etc. On the other hand, it sells the finished products to the consumers, wholesaler, retailer etc. Business makes available various goods and services to the different sections of the society.

3. Continuous process:

Business is not a single time activity. It is a continuous process of production and distribution of goods and services. A single transaction of trade cannot be termed as a business. A business should be conducted regularly in order to grow and gain regular returns.

Business should continuously involve in research and developmental activities to gain competitive advantage. A continuous improvement strategy helps to increase profitability of the business firm.

4. Profit Motive:

Profit is an indicator of success and failure of business. It is the difference between income and expenses of the business. The primary goal of a business is usually to obtain the highest possible level of profit through the production and sale of goods and services. It is a return on investment. Profit acts as a driving force behind all business activities.

Profit is required for survival, growth and expansion of the business. It is clear that every business operates to earn profit. Business has many goals but profit making is the primary goal of every business. It is required to create economic growth.

5. Risk and Uncertainties:

Risk is defined as the effect of uncertainty arising on the objectives of the business. Risk is associated with every business. Business is exposed to two types of risk, Insurable and Non-insurable. Insurable risk is predictable.

6. Creative and Dynamic:

Modern business is creative and dynamic in nature. Business firm has to come out with creative ideas, approaches and concepts for production and distribution of goods and services. It means to bring things in fresh, new and inventive way.

One has to be innovative because the business operates under constantly changing economic, social and technological environment. Business should also come out with new products to satisfy the growing needs of the consumers.

7. Customer satisfaction:

The phase of business has changed from traditional concept to modern concept. Now a day, business adopts a consumer-oriented approach. Customer satisfaction is the ultimate aim of all economic activities.

Modern business believes in satisfying the customers by providing quality product at a reasonable price. It emphasize not only on profit but also on customer satisfaction. Consumers are satisfied only when they get real value for their purchase.

The purpose of the business is to create and retain the customers. The ability to identify and satisfy the customers is the prime ingredient for the business success.

8. Social Activity:

Business is a socio-economic activity. Both business and society are interdependent. Modern business runs in the area of social responsibility.

Business has some responsibility towards the society and in turn it needs the support of various social groups like investors, employees, customers, creditors etc. by making goods available to various sections of the society, business performs an important social function and meets social needs. Business needs support of different section of the society for its proper functioning.

9. Government control:

Business organisations are subject to government control. They have to follow certain rules and regulations enacted by the government. Government ensures that the business is conducted for social good by keeping effective supervision and control by enacting and amending laws and rules from time to time.

10. Optimum utilisation of resources:

Business facilitates optimum utilisation of countries material and non-material resources and achieves economic progress. The scarce resources are brought to its fullest use for concentrating economic wealth and satisfying the needs and wants of the consumers.

**Objectives of Business Organisation**

Economic Objectives:

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

**(i) Profit Earning:**

Profit is the lifeblood of business, without which no business can survive in a competitive market. In fact profit making is the primary objective for which a business unit is brought into existence. Profits must be earned to ensure the survival of business, its growth and expansion over time.

Profits help businessmen not only to earn their living but also to expand their business activities by reinvesting a part of the profits. In order to achieve this primary objective, certain other objectives are also necessary to be pursued by business, which are as follows:

**(a) Creation of customers:**

A business unit cannot survive unless there are customers to buy the products and services. Again a businessman can earn profits only when he/she provides quality goods and services at a reasonable price. For this it needs to attract more customers for its existing as well as new products. This is achieved with the help of various marketing activities.

**(b) Regular innovations:**

Innovation means changes, which bring about improvement in products, process of production and distribution of goods. Business units, through innovation, are able to reduce cost by adopting better methods of production and also increase their sales by attracting more customers because of improved products.

Reduction in cost and increase in sales gives more profit to the businessmen. Use of power looms in place of handlooms, use of tractors in place of hand implements in farms etc. are all the results of innovation.

**(c) Best possible use of resources:**

As we all know, to run any business we must have sufficient capital or funds. The amount of capital may be used to buy machinery, raw materials, employ men and have cash to meet day-to-day expenses. Thus, business activities require various resources like men, materials, money and machines.

The availability of these resources is usually limited. Thus, every business should try to make the best possible use of these resources. Employing efficient workers. Making full use of machines and minimizing wastage of raw materials, can achieve this objective.

<u>B. Social Objectives:</u>

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

If business activities lead to socially harmful effects, there is bound to be public reaction against the business sooner or later. Social objectives of business include production and supply of quality goods and services, adoption of fair trade practices and contribution to the general welfare of society and provision of welfare amenities.

**(i) Production and Supply of Quality Goods and Services:**

Since the business utilizes the various resources of the society, the society expects to get quality goods and services from the business he objective of business should be to produce better quality goods and supply them at the right time and at a right price It is not desirable on the part of the businessman to supply adulterated or inferior goods which cause injuries to the customers.

They should charge the price according to the quality of e goods and services provided to the society. Again, the customers also expect timely supply of all their requirements. So it is important for every business to supply those goods and services on a regular basis.

**(ii) Adoption of Fair Trade Practices:**

In every society, activities such as hoarding, black- marketing and over-charging are considered undesirable. Besides, misleading advertisements often give a false impression about the quality of products. Such advertisements deceive the customers and the businessmen use them for the sake of making large profits.

This is an unfair trade practice. The business unit must not create artificial scarcity of essential goods or raise prices for the sake of earning more profits. All these activities earn a bad name and sometimes make the businessmen liable for penalty and even imprisonment under the law. Therefore, the objective of business should be to adopt fair trade practices for the welfare of the consumers as well as the society.

**(iii) Contribution to the General Welfare of the Society:**

Business units should work for the general welfare and upliftment of the society. This is possible through running of schools and colleges better education opening of vocational training centres to train the people to earn their livelihood, establishing hospitals for medical facilities and providing recreational facilities for the general public like parks, sports complexes etc.

C. Human Objectives:

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

**(i) Economic Well-being of the Employees:**

In business employees must be provided with tan remuneration and incentive for performance benefits of provident fund, pension and other amenities like medical facilities, housing facilities etc. By this they feel more satisfied at work and contribute more for the business.

**(ii) Social and Psychological Satisfaction of Employees:**

It is the duty of business units to provide social and psychological satisfaction to their employees. This is possible by making the job interesting and challenging, putting the right person in the right job and reducing the monotony of work Opportunities for promotion and advancement in career should also be provided to the employees.

Further, grievances of employees should be given prompt attention and their suggestions should be considered seriously when decisions are made. If employees are happy and satisfied they can put then best efforts in work.

**(iii) Development of Human Resources:**

Employees as human beings always want to grow. Their growth requires proper training as well as development. Business can prosper if the people employed can improve their skills and develop their abilities and competencies in course of time. Thus, it is important that business should arrange training and development programmes for its employees.

**(iv) Well-being of Socially and Economically Backward People:**

Business units being inseparable parts of society should help backward classes and also people those are physically and mentally challenged. This can be done in many ways. For instance, vocational training programme may be arranged to improve the earning capacity of backward people in the community. While recruiting its staff, business should give preference to physically and mentally challenged persons. Business units can also help and encourage meritorious students by awarding scholarships for higher studies.

D. National Objectives:

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

The following are the national objectives of business.

**(i) Creation of Employment:**

One of the important national objectives of business is to create opportunities for gainful employment of people. This can be achieved by establishing new business units, expanding markets, widening distribution channels, etc.

**(ii) Promotion of Social Justice:**

As a responsible citizen, a businessman is expected to provide equal opportunities to all persons with whom he/she deals. He/ She is also expected to provide equal opportunities to all the employees to work and progress. Towards this objectives special attention must be paid to weaker and backward sections of the society.

**(iii) Production According to National Priority:**

Business units should produce and supply goods in accordance with the priorities laid down in the plans and policies of the government. One of the national objectives of business in our country should be to increase the production and supply of essential goods at reasonable prices.

**(iv) Contribute to the Revenue of the Country:**

The business owners should pay their taxes and dues honestly and regularly. This will increase the revenue of the government, which can be used for the development of the nation.

**(v) Self-sufficiency and Export Promotion:**

To help the country to become self-reliant, business units have the added responsibility of restricting import of goods. Besides, every business units should aim at increasing exports and adding to the foreign exchange reserves of the country.

E. Global Objectives:

Previously India had very restricted business relationship with other nations. There was a very rigid policy for import and export of goods and services. But, now-a-days due to liberal economic and export-import policy, restrictions on foreign investments have been largely abolished and duties on imported goods have been substantially reduced.

This change has brought about increase in competition in the market. Today because of globalisation the entire world has become a big market. Goods produced in one country are readily available in other countries. So, to face the competition in the global market every business has certain objectives in mind, which may be called the global objectives. Let us learn about them.

**(i) Raise General Standard of Living:**

Growth of business activities across national borders makes quality goods available at reasonable prices all over the world. The people of one country get to use similar types of goods that people in other countries are using. This improves the standard of living of people.

**(ii) Reduce Disparities among Nations:**

Business should help to reduce disparities among the rich and poor nations of the world by expanding its operation. By way of capital investment in developing as well as underdeveloped countries it can foster their industrial and economic growth.

**(iii) Make Available Globally Competitive Goods and Services:**

Business should produce goods and services which are globally competitive and have huge demand in foreign markets. This will improve the image of the exporting country and also earn more foreign exchange for the country.

Evolution of Business

The economic development of a country is measured by the development of commerce and industry. The development of business activities in India has been going on with the changes in civilisation. There was a time when there was no commerce at all and now its development has brought the whole world together. There have been different stages through which the development of trade and industry has passed.

**A brief description of evolution of business activities has been discussed herewith:**

1. **Barter System:**

Barter is a system of exchange of goods for goods. The earlier system of producing or percuring only for one’s needs gave way to barter system. With the increase in demand for more and more goods and surplus in one’s own production, there was a search for those who wanted to exchange goods for goods. The families started producing more than their needs.

The surpluses were exchanged with those goods which they needed. At a later stage some places were fixed where people used to come for exchanging their surplus products with others. The payment for using the services of other people was also in kind. Though commerce had come into being but it was at an elementary level. There was a problem of bringing together persons who needed each other’s goods. There was no common yardstick for measuring the value of goods to be exchanged.

2. **Village Economy:**

People started setting at particular places and began to sow seeds and rearing cattle on the land which they shared with community. These tribes started producing the things which they required and it was a system of self-sufficiency. With the advent of private ownership of land and cattle, the tribe system split into families. Some families started concentrating on occupations other than agriculture.

This led to exchange of goods for satisfying family needs. There was a system of village economy and all the requirements of the village were met by the people themselves. In order to facilitate exchange, a class of people called traders also emerged. Different families started specialising in producing different goods or taking up specific jobs. All these developments led to a self-reliant village economy.

3. **Introduction of Money:**

The difficulties faced in barter system compelled people to find out some common medium for exchange. In the beginning some commodities were used as a denominator for exchange. The commodities like stones, shells, cattle, feathers etc. were used to value the goods to be exchanged. Gradually, metals like iron, copper, bronze, silver and gold were taken to be more convenient, as a medium of exchange.

The metals were weighed and stamped to fix their value. The metal money facilitated trade not only in the country but also with foreign countries. The coins were also used to make payments for various types of services availed. It was ultimately the use of paper currency which led to all round development of business activities.

4. **Town Economy:**

With the use of money for exchange purposes, the volume of trade started increasing. The system of self-sufficiency gave way to division of labour. Instead of producing for family needs people started meeting needs of the whole village. People started specialising in different products. Certain places were being fixed where people could come to buy and sell goods.

There used to be weekly mandis or fairs where people from nearby villages would come to sell their surplus products and buy goods for their needs. The mandis or fairs became a regular feature. The increased volume of trade encouraged more and more division of labour. A separate class of traders and artisans came into existence.

These persons started settling at central places and established their business premises there. These places were known as towns and became trade centres for people living in villages. The villagers brought raw materials, cattle, milk, etc. to the towns for sale. The artisans would manufacture goods as per the needs of the people. The traders became a link between farmers and artisans.

The traders also started bringing luxury goods from outside places for sale in towns. As the journey was risky, the traders used to move in caravans and with the protection of armed men. The town economy gave further philip to commerce.

5. **Industrial Revolution:**

The word 'Industrial Revolution' is used to describe a series of changes in the industrial field in England during the period between 1760 and 1850. The changes of far reaching effects took place during this period. Generally, the word 'Revolution' is used for an abrupt change but in this case it is used to describe 'fundamental change'.

A number of inventions took place in England which changed the entire technique of production. Some of the important inventions were the Spinning Jenny of Hargreaves, the Water Frame of Arkwright, the Mule of Crompton and the Power-loom of Cartwright. With the help of these inventions industrial production started at a mass scale.

The machinery was used for production, division of labour was introduced and the modes of transport were improved. The use of steam-engine in place of labour helped to increase production manifold. The use of machines required more capital investments and it led to the change in ownership from a sole proprietorship to a joint stock company.

According to Mr. L.C.A Knowles, "The so-called Industrial Revolution comprised of six great changes or developments-all of which were inter-dependent".

**These changes were:**

**(i) Development of Engineering:**

Industrial revolution brought about a change in engineering skill. Engineers were required to design machines for textile and coal-mixing industries. The tool making for repairing ships and locomotives were also essential. There was a need for sufficient number of trained persons for taking up these jobs. The development of trained people was a part of industrial revolution.

**(ii) Revolution in Iron-making:**

The casting of iron for manufacturing machines was the other need of this revolution. A sufficient quantity and goods of iron was the need of the time. This development helped in producing sufficient number of machines.

**(iii) Use of Steam Power in Textiles:**

The use of mechanical devices in textile industry raised its production. First steam power was used in spinning. It created a surplus of yarn because man-made and traditional methods of weaving could not cope with the situation. It necessitated the use of power for weaving purposes also. The use of power was also extended to other aspects of textile industry.

**(iv) Rise of Chemical Industry:**

The use of power in textile industry necessitated suitable changes in the processes like bleaching, dying, finishing or printing so that production could be accelerated to keep pace with the output of piece goods. All this was possible only with the development of chemical industry.

**(v) Development of Coal Mining:**

The development of coal mining was inter-dependent on other developments. The coke was needed for smelting and refining iron and pig iron respectively in blast furnaces as also for producing the steam power which had also become the motive power of the industry.

**(vi) Revolution in Transport:**

The above mentioned developments could not have been possible without the improved modes of transport. The horse driven carriages could not cope with the needs of large scale production. The moving of inputs to centres of industrialization and then distribution of manufactured goods to places of consumption will be possible only with better transport means.

The industrial revolution led to large scale production. The production large scale reduced prices of goods. The commodities which were considered luxuries earlier were within the reach of a common man. The division of labour was introduced in factories and this led to specialisation.

6. **Revolution in Transport and Communication:**

Industrial production increased manifold after the mechanisation of production methods. There was a need for more and more markets to sell the goods. The discovery of new sea routes, opening of Suez Canal, introduction of railways, steamships, aeroplanes and automobiles revolutionised transport system. The movement of goods among different countries became easy and fast. The trade crossed national boundries.

The trade expanded from local to national and from national to international boundries. The facilities such as insurance and banking also gave philip to the development of trade. The revolution in communication methods has further facilitated the growth of business activities.

The use of telephone, telegraph, radio, T.V. etc. has helped in creating world market for goods. The latest edition of internet, intranet, e-commerce and advanced IT methods has radically changed the structure of trade and commerce both at national and international levels.

7. **Advancements in Modern Business:**

A number of advancements have occurred in commerce and industry in the last fifty years. These changes have revolutionised production and distribution.

**Some of these changes are described as follows :**

**(i) Improved Methods of Production:**

The use of latest technology has revolutionised production methods. The rate of production has increased substantially. Mechanisation and automation have also helped in controlling wastes and reducing cost of production. Productivity of workers has also gone up.

**(ii) Large Scale Production:**

The growth of multinational companies has increased the scale of production. The goods are not produced for local or national markets only but international demand is taken into consideration.

**(iii) Specialisation:**

The division of labour has led to specialisation in every industrial activity. Industrial units produce small number of components but specialise in them. Big industrial units also encourage specialisation in small units. The specialisation helps in raising productivity and competitive strength of the units. Even at international level countries produce only those goods in which they can specialise and have natural advantage. This specialisation has further increased international trade.

**(iv) Research and Development:**

The focus of industrial units is to devise better and better products on a regular basis. This has necessitated an emphasis on research and development. The thrust now is on revolution and not on evolution. Research and development helps in controlling costs, increasing production and raising standards of living of people.

**(v) Expansion of International Trade:**

International trade is expanding at a greater pace. The organisations like WTO are helping to bring together the whole world by removing various hindrances imposed by countries in the flow of goods and services. The whole world is now becoming one big market.

8. **Growth of Public and Private Enterprises:**

   Industrialisation in India mainly started after 1947. British rulers wanted India to be the supplier of raw materials and consumer of their finished goods. After independence the government devised specific roles to public and private sectors. Basic and strategic industries were developed under public sector and consumer goods industries were left to be developed under private sector.

   There were a number of changes in industrial policy from time to time. The public sector enterprises could not provide the required quantum for industrial development. It was in 1991 when government decided to limit the role of public sector only to a few industries and rests of the industries were left to be developed by private sector. Foreign entrepreneurs were freely allowed to set up unit in India.

   A number of multinational companies, especially in automobile sector and durable consumer goods, have set up their manufacturing facilities in India. Foreign investors are allowed to own majority of equity in a number of Indian industries.

   There are basic structural changes in Indian industrial sector in the last 15 years. Under world trade treaties every country has to .allow free access to foreign goods. Indian industries are now operating under intense competition from foreign undertakings. This competition has created awareness about quality and cost among Indian entrepreneurs. Indian exports are now finding good foreign markets.

   Businessmen are exploring newer and better foreign markets for Indian goods. The government is also giving proper attention to export promotion. Though public sector is also continuing but the thrust has shifted to private sector. Private sector will have to show results in a fairly competitive environment.

   Modern Businesses

   Companies that have rapidly reshaped their categories to place previous leaders at a disadvantage or who have created entirely new categories of their own. They have employed a dizzying array of new techniques and technologies and it is often hard to separate their strategy from their execution. However, as more of these companies emerge, it has become clear that there are a consistent set of fundamentals that they all have in common.

1. Committed deeply to delivering individual, social and environmental value that is tightly aligned with the creation of economic value for its stakeholders.
2. Built around a purpose: Enlists employees, customers and partners to help achieve the purpose.
3. Design workplaces and cultures that install employees with passion and autonomy: Employ flatter structures, offer more holistic, human work.
4. Transparent, open and sharing by default. View operations and culture as a competitive advantage.
5. Create ecosystems of shared value within their industry: Utilize platforms and networks to scale value creation and further social and economic goals for a wide range of stakeholders and partners
6. Primarily profit through eliminating waste and breaking barriers within their industries or categories or through enabling greater value for partners and customers.

7. Deliver real value to people and the community, build relationships with customers not transactions
8. Make real progress against social goals and commercial goals

Business & Profession

**Business** means to earn profit by supplying goods and services, whereas profession is an advice or service rendered by one or a group of persons which does not include manufacturing or selling of goods.

In order to become a professional, a person has to attain certain academic qualifications and training. Examples are Chartered Accountants, Doctors, Advocates, Engineers, Cost Accountants and Company Secretaries.

The points of difference between business and profession are given below.

1. **Difference in Educational Qualifications**

   The professional should have the specified academic qualifications to practice the profession, whereas the businessman is not expected to have such specified academic qualifications.

2. **Difference in Expert in the Field**

   The businessman need not have expertise knowledge in his field of business. On the other hand, the professional must be an expert in his profession.

3. **Difference in Personal Attention**

   The businessman can appoint anybody to manage the affairs of his business. The professional, on the other hand, has to perform the duties personally.

4. **Difference in Name of the Reward**

   The reward for business is known as profit. The reward for profession is called as fee.

5. **Difference in Code of Conduct and Ethics**

   There is no rigorous code of conduct and ethics to be followed by a businessman. The professional, on the other hand is expected to follow code of conduct and ethics.

6. **Difference in Governing Body**

   Association does not govern the business man. He may or may not be a member of any trade association. On the other hand, the association to which he belongs governs the professional.

7. **Difference in Motive**

   The primary motive of a businessman is profit. The basic motive of a professional is service, and profit is only secondary.

8. **Difference in Advertisement**

   The businessman can advertise his business to attract more and more customers towards his business. A professional, on the other hand, cannot advertise except displaying a name board in front of his office.

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**SCHOOL OF MANAGEMENT STUDIES**

# UNIT II - BUSINESS ORGANISATION – SBAA 1104

Business Unit

**A Business Unit** is most commonly recognized as an independent transaction-processing entity. It is defined as an organization or the subset of an organization which is independent in its accounting and operational functionality. A Business Unit is basically a profit making centre which has a prime focus to segment the market and be able to enhance the product offerings of the company. They usually have a separate clearly defined marketing plan, a well-defined marketing campaign and a detailed analysis of the competition, even when they are essentially a part of a bigger business entity.

In organizations, subsidiaries are often confused with business units. But these two have some significant differences. A company which is at least 50 percent owned by another company, more commonly known as the parent company is referred to as a subsidiary. The subsidiary is a complete corporate body, whereas the business units are sub-components or components of these subsidiaries. Business units are a smaller entity like a department or a functional group within a company which is responsible for handling the issues and affairs of that specific activity. Examples of business units include marketing, finance, operations, accounting, sales, human resources and research and development divisions.

Companies can have multiple independent business units into itself or as a branch, and each one of them is responsible for their own profitability. For example: General Electric is a company having 49 business units.

There are three important parameters that are usually seen as the success determining factors of a business unit:

- The autonomy and power delegated to a business unit manager
- The degree of functionality and facility sharing between multiple SBUs
- The way of handling new products in organizations

Establishing a new Business unit

**Step 1. Idea Generation:**

To kick start operations, entrepreneurs must be imbued with rich ideas that can work. In order to generate ideas, entrepreneurs need to have an eye for detail. They should keep a close watch over changing trends in the market place and identify gaps that can be profitably exploited.

**Step 2. Nature of Business:**

**The entrepreneur should be clear about the nature of type of business that he wants to be in:**

1. What type of business- Wholesale or retail, independent or franchise business or simply a trading business.
2. What to offer- Products or services or a mix of both; he wants to trade in these or wants to produce and distribute.

3. III. In Which sector- Entertainment, construction, software, hardware, fashion, etc.
4. Is it a profitable business or a risky one -Carefully studying the prospects of chosen business. He needs to calculate the gains, the challenges ahead and the type of risks that exist and the viability of business in the long run.
5. Whether inputs, resources and requisite manpower available- It is better to carry out a feasibility study of everything beforehand.
6. Whether the idea will actually work or not- To this end, he has to conduct a feasibility study examining the pros and cons of everything.
7. Prepare the business plan and move ahead with other steps that follow the decision.

**Step 3. Determine the Size and Scale of Operations:**

The entrepreneur should be clear about what kind of sales could be generated at different price points. He should plan for a volume that recovers his costs fully and generates enough profits for survival initially. Then he can think of expanding volumes, size and scale of operations. A gradual step by step, trial and error process is what most market experts suggest. Rushing into catch a temporary wave of demand created by artificial mismatch between demand and supply might eventually put a very good business also on the stretcher.

For a budding small business venture, size should not be a fascinating option unless the market is totally ignored, unexplored or underserved (like it happened in the case of iodized salt, vegetarian tooth paste, low priced but reasonable quality detergents; multigrain wheat flour, etc.) The size and scale of operations chosen must be in sync with what the entrepreneur has in terms of available capital and other resources at his command.

**Step 4. Select a Place for Business:**

The entrepreneur must pick up a location that is closer to all the inputs, resources and materials that the business would require. Availability of manpower and transport links also need to be looked into. Other services like banking, telecommunications, and power supply need closer attention of course, different organisations in the same industry may have different facilities requirements.

For example Benetton uses only one distribution centre for the entire world, whereas Wal-Mart has several distribution centres in the United States alone. In any case, a small business owner of retail business must pay close attention to the convenience factor especially from the customers' point of view.

**Step 5. Choose the Form of Ownership:**

The entrepreneur must be clear about the form of ownership that is closer to his heart. He could think of a small business owned by him exclusive or start the venture in partnership with someone or create a company with diversified shareholding. To start with, he can pick up the entity that is easy to form, simple to operate, allows freedom to implement his ideas without any legal or taxation problems and gives him enough room to expand further, whenever the opportunity turns out to be big.

**Step 6. Determine Financial Requirements:**

Here it is a question of calculating the fixed capital and working capital needs of the firm, keeping the present and future plans of the business in mind. The entrepreneur should be clear about the type of expenses that are going to eat up resources at different points of time. Requisite funds for emergency use need to be put in place. The sources of funds also need to be calculated well in advance. How much through bank financing, how much from the long term lending institutions, how much from the general public—if equity is a preferred option—how much from own sources etc.?

**Step 7. Plan for Physical Facilities:**

This is a question of giving a concrete shape to the business plan by arranging the physical infrastructure required. It includes decisions regarding machines, equipment, factory and office design, choosing furniture, space planning, providing for repair and maintenance, availability of spare parts, degree of sophistication required in terms of modernizing the plant in every way—keeping the availability of skilled hands in the chosen location etc. An appropriate organisation structure must also be designed keeping the space needs of various departments, divisions and plants in mind.

**Step 8. Select an Appropriate Plant Layout:**

The choice of physical configuration or the layout of facilities is closed related to other operation decisions. A product layout is appropriate when large quantities of a single product are needed. It makes sense to custom design a straight line flow of work for a product when a specific task is performed at each work station as each unit flows past. Most assembly lines use this format.

For example, Dell's personal computer factories use a product layout. The type of layout depends on the expected volume of production, space available, type of equipment, etc. The chosen layout, in any case, must be in sync with space available and must permit easy flow of production without posing any danger to human life.

**Step 9. Determine Human Resource Requirements:**

Here it is a question of finding human resource requirements in terms of physical numbers and also in terms of quality such as technical skill sets, managerial competencies, degree of expertise, necessity for people possessing latest knowledge in a high-tech area etc. The necessity for hiring people with qualities of head and heart must be recognized and the small business owner must keep plans ready for this purpose.

**Step 10. Keep an Eye on Legal and Procedural Requirements:**

All approvals, sanctions must be obtained well in advance. The needed paper work must be entrusted to experienced people hired for this purpose. Help from external consultants could also be obtained to avoid surprises of various kinds hitting the budding venture at a later stage. All taxation matters be carefully looked into at this stage. If required, the owner must carry out a drill looking into each and every detail personally.

**Step 11. Launch the Business:**

The owner should get ready to launch the business formally after acquiring physical and financial resources, providing for infrastructural facilities and hiring the people needed.

Meaning of Promotion

**Promotion** is a type of communication between the buyer and the seller. The seller tries to persuade the buyer to purchase their goods or services through promotions. It helps in making the people aware of a product, service or a company. It also helps to improve the public image of a company. This method of marketing may also create interest in the minds of buyers and can also generate loyal customers.

It is one of the basic elements of the market mix, which includes the four P's: price, product, promotion, and place. It is also one of the elements in the promotional mix or promotional mix or promotional plan. These are personal selling, advertising, sales promotion, direct marketing publicity and may also include event marketing, exhibitions, and trade shows.

## Types of Promotion

### Advertising

Advertising means to advertise a product, service or a company with the help of television, radio or social media. It helps in spreading awareness about the company, product or service. Advertising is communicated through various mass media, including traditional media such as newspapers, magazines, television, radio, outdoor advertising or direct mail; and new media such as search results, blogs, social media, websites or text messages.

### Direct Marketing

Direct marketing is a form of advertising where organizations communicate directly to customers through a variety of media including cell phone text messaging, email, websites, online adverts, database marketing, fliers, catalog distribution, promotional letters and targeted television, newspaper and magazine advertisements as well as outdoor advertising. Among practitioners, it is also known as a direct response.

### Sales Promotion

Sales promotion uses both media and non-media marketing communications for a pre-determined, limited time to increase consumer demand, stimulate market demand or improve product availability.

### Personal Selling

The sale of a product depends on the selling of a product. Personal Selling is a method where companies send their agents to the consumer to sell the products personally. Here, the feedback is immediate and they also build a trust with the customer which is very important.

### Public Relation

Public relation or PR is the practice of managing the spread of information between an individual or an organization (such as a business, government agency, or a nonprofit organization) and the public. A successful PR campaign can be really beneficial to the brand of the organization.

Features for business

Characteristics are the features which are necessary to classify the business. Therefore let's have a look at them.

**Economic Activity**

Business necessarily has to be an economic activity. But what exactly is an economic activity? Any activity that gives a monetary return is an economic activity. For example, if your friend's father picks you up and drops you at college every day, he is doing this act out of kindness. But if he starts a transportation service of picking up and dropping by charging money then it's an economic activity.

**Production or Trading of Good or Services for Sale**

If a business plans on selling a product, it has to either manufacture that product or purchase it and add a profit margin to it and sell it further. Business is interested in every activity that is concerned with the production or purchase of goods for selling, this makes it one of the most important characteristics of a business. Services for sale include transportation, housekeeping, and security. Whereas, goods are mostly consumable items.

Sale or Exchange of Goods and Services

The third and crucial one of the characteristics of business after production or procurement is to sell that product for the money. The way to sell a product or service is by launching it in the market or to offer it for sale. A sale or exchange must take place between the seller and the buyer.

Regularity in Dealings

Business is a repeatable economic activity that generates money. For example, if you sell your old bike and it generates money. Also, it's an economic activity but is you doing this on a regular basis? No. As it has no regularity in it, it cannot be accepted as a business activity. Similarly, there is a dealer who deals in the purchase and sells of second-hand bikes. For him, it's a business activity as there is a regularity in his dealing. A single transaction of purchase or sale cannot be classified as a business.

Profit Earning

The sole purpose of business is the maximization of profit. It steps into the market with the main objective of earning a profit. For the survival of business in a market, generating profit is extremely necessary. If a business can't produce profit, it is expected of it to go downhill financially. Therefore the businessman does all the possible tricks to maximize its profits by increasing the volume of sales or decreasing the costs

Risk Factor

It is well known "Higher the risks, higher the return". Business attracts risk. While initiating business it is not guaranteed 100% that the business will be successful. There is an anticipation that there might be demand for its product or service in the market. But the market is always dwindling the subject to risk. The business may even earn profit but the amount of profit earned may vary.

Uncertainty of Returns

Businessmen invest huge capital in their activities to sustain and extract profit from the business. As we discussed the risk above, it is very uncertain as to what amount the profit will be earned. Often there are situations where is no return of profit. There are always chances of losses in the business activities.

Legal Activity

The business has to be legal and lawful. Business is an extremely important activity for a country but it is not above the law. Every economic activity has to be within the limits of the law. The country's legislation puts clauses on the functioning of the business to control its activities.

Plant location

**Location of an industry** is an important management decision. It is a two-step decision: first, choice of general area or region and second, the choice of site within the area selected. Location decision is based on the organisations long-term strategies such as technological, marketing, resource availability and financial strategies.

The objective of plant location decision-making is to minimise the sum of all costs affected by location.

**Plant location is important because of the following:**

(i) Location influences plant layout facilities needed.

(ii) Location influences capital investment and operating costs.

Location decisions are strategic, long-term and non-repetitive in nature. Without sound and careful location planning in the beginning itself, the new facilities may create continuous operating problems in future. Location decision also affects the efficiency, effectiveness, productivity and profitability.

The location decision should be taken very carefully, as any mistake may cause poor location, which could be a constant source of higher cost, higher investment, difficult marketing and transportation, dissatisfied and frustrated employees and consumers, frequent interruptions of production, abnormal wastages, delays and substandard quality etc.

Therefore, it should be based upon a careful consideration of all factors that are essentially needed in efficient running of a particular industry. The necessary factors in the selection of plant location vary among industries and with changing technical and economical conditions.

Site selection is not an easy problem because if the selection is not proper then all money spent on factory building, machinery and their installation etc., will go as waste and the owner has to suffer a great loss. Therefore, while selecting a site, owner must consider technical, commercial, financial aspects which may provide maximum advantages.

It is sometimes possible that all the requirements and features of ideal site may not be available at one particular location but then it will be advantageous to find out suitable site with combinations of all essential requirements of the particular industry to be established as explained in following paras.

Market Location:

**To solve such problems a market analysis of the area is conducted and answers of the following questions can be found out:**

1. If there is a market which could be served and if retail price of product can be reduced?
2. Whether quick delivery of the product can be made by better plant location to the particular market?
3. Whether there is a competitor for the product in the market? Whether demand for product may increase? Whether an additional plant is required to meet the future demand?
4. What is the potential purchasing power of the market?
5. What are the buying habits of local people, and what must be done to fit your service to these habits?

Economical Aspects:

Locational economics for an enterprise includes a consideration of the product to be manufactured, the processes and machinery to be used, and the service and facilities required.

**To know this the following factors may be studied:**

1. **Product**:

   (a) Nature,
   (b) Volume, and
   (c) Value.
   **Production process:**
   (a) Continuous,
   (b) Intermittent, and
   (c) Interrupted.

3. **Manufacturing machinery.**
4. **Other manufacturing equipment’s.**
5. **Special manufacturing requirement.**
6. **Service:**

(a) Steam,

(b) Gas,

(c) Water,

(d) Air or high pressure,

(e) Electricity, and

(f) Sewerage.

## Plant Layout

## Meaning of Plant Layout

**Plant layout** is the arrangement of machines, work areas and service areas within a factory. George R. Terry. **Plant layout** involves the development of physical relationship among building, equipment and production operations, which will enable the manufacturing process to be carried on efficiently.

Need of Plant Layout:

Many situations give rise to the problem of plant layout. Two plants having similar operations may not have identical layouts. This may be due to size of the plant, nature of the process and management's calibre.

**The necessity of plant layout may be felt and the problem may arise when:**

(i) There are design changes in the product.
(ii) There is an expansion of the enterprise.
(iii) There is proposed variation in the size of the departments.
(iv) Some new product is to be added to the existing line.
(v) Some new department is to be added to the enterprise and there is reallocation of the existing department.
(vi) A new plant is to be set up.

## Importance of Plant Layout:

The layout of a plant is quite important in view of the above definition but the importance of a layout may greatly vary from industry to industry.

**The possibility of attaining the best possible layout is directly proportional to following factors:**

(i) The Weight, Volume or Mobility of the Product:

If the final product is quite heavy or difficult to handle involving costly material handling equipment or a large amount of labour, important consideration will be to move the product minimum possible e.g. boiler, turbines, locomotive industries and ship building companies etc.

(ii) Complexity of the Final Product:

f the product is made up of a very large number of components and parts i.e. large number of people may be employed for handling the movement of these parts from shop to shop or from machine to machine or one assembly point to another e.g. automobile industry.

(iii) The Length of the Process in Relation to Handling Time:

If the material handling time represents a appreciable proportion of the total time of manufacturing, any reduction in handling time of the product may result in great productivity improvement of the industrial unit e.g. Steam Turbine Industry.

(iv) The Extent to which the Process Tends towards Mass Production:

With the use of automatic machines in industries for adopting mass production system of manufacturing the volume of production will increase. In view of high production output, larger percentage of manual labour will be engaged in transporting the output unless the layout is good.

## Objectives of Good Plant Layout:

A good rather an optimum layout is one which provides maximum satisfaction to all concerned i.e. shareholders, management employees and consumers.

**The objectives of a good layout are as follows:**

(i) Should provide overall satisfaction to all concerned.

(ii) Material handling and internal transportation from one operation to the next is minimized and efficiently controlled.

(iii) The production bottle necks and points of congestions are to be eliminated so that input raw materials and semi-finished parts move fast from one work station to another.

(iv) Should provide high work in process turnover.

(v) Should utilize the space most effectively; may be cubical utilization.

(vi) Should provide worker's convenience, promote job satisfaction and safety for them.

(vii) Should avoid unnecessary investment of capital.

(viii) Should help in effective utilization of labour.

(ix) Should lead to increased productivity and better quality of the product with reduced capital cost.

## Types of Plant layout

### Four Main Types of Plant Layout

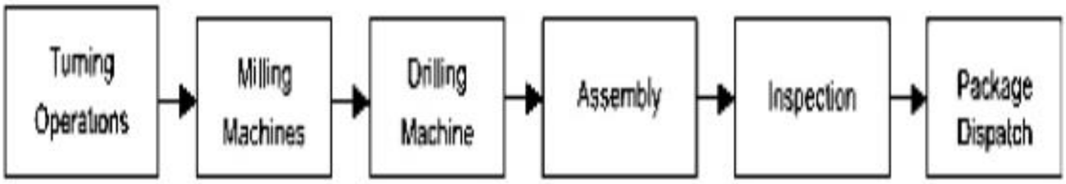
1. Product or Line Layout
2. Process or Functional Layout.
3. Fixed Position Layout.
4. Combination type of Layout.

### 1. Product or Line Layout

If all the processing equipment and machines are arranged according to the sequence of operations of the product, the layout is called product type of layout. In this type of layout, only one product of one type of products is produced in an operating area. This product must be standardized and produced in large quantities in order to justify the product layout.

The raw material is supplied at one end of the line and goes from one operation to the next quite rapidly with a minimum work in process, storage and material handling. Fig. 8.3 shows product layout for two types of products A and B.

Model of product Lay-out




**Advantages offered by Product Layout:**

(i) Lowers total material handling cost.

(ii) There is less work in processes.

(iii) Better utilization of men and machines,

(iv) Less floor area is occupied by material in transit and for temporary storages.

(v) Greater simplicity of production control.

(vi) Total production time is also minimized.

**Limitations of Product Layout:**

(i) No flexibility which is generally required is obtained in this layout.

(ii) The manufacturing cost increases with a fall in volume of production.

(iii) If one or two lines are running light, there is a considerable machine idleness.

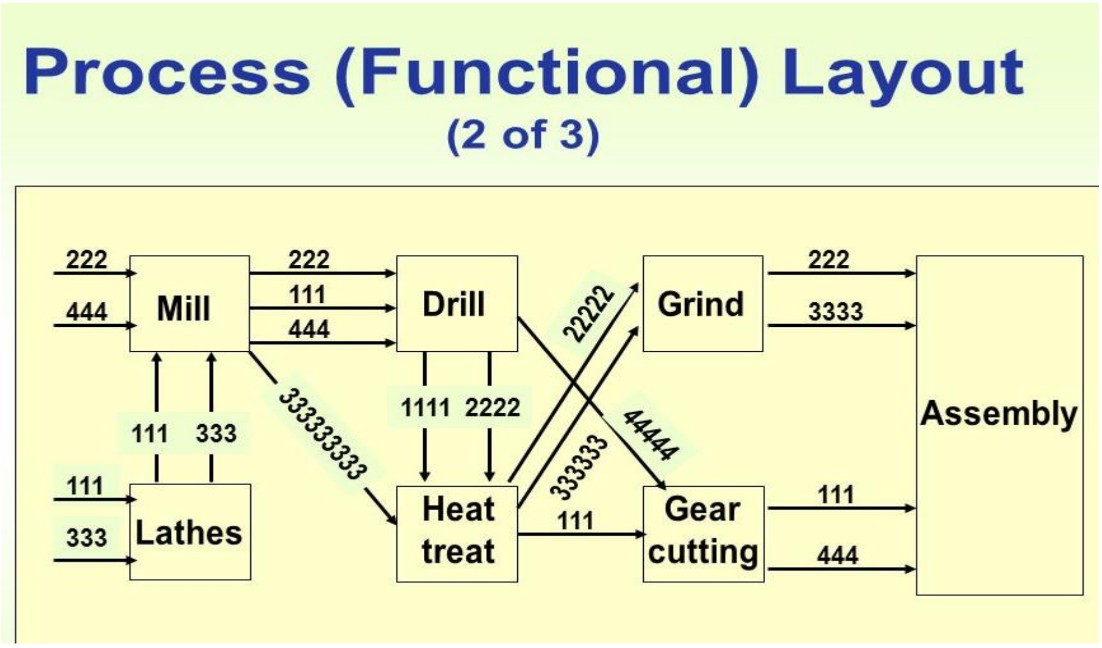
(iv) A single machine break down may shut down the whole production line.

(v) Specialized and strict supervision is essential.

2. **Process or Functional Layout**

The process layout is particularly useful where low volume of production is needed. If the products are not standardized, the process layout is more low desirable, because it has creator process flexibility than other. In this type of layout, the machines and not arranged according to the sequence of operations but are arranged according to the nature or type of the operations. This layout is commonly suitable for non repetitive jobs.

Same type of operation facilities are grouped together such as lathes will be placed at one place, all the drill machines are at another place and so on. See Fig. 8.4 for process layout. Therefore, the process carried out in that area is according to the machine available in that area.




**Advantages of Process Layout**

(i) There will be less duplication of machines. Thus, total investment in equipment purchase will be reduced.

(ii) It offers better and more efficient supervision through specialization at various levels.

(iii) There is a greater flexibility in equipment and man power thus load distribution is easily controlled.

(iv) Better utilization of equipment available is possible.

(v) Break down of equipment can be easily handled by transferring work to another machine/work station.

(vi) There will be better control of complicated or precision processes, especially where much inspection is required.

**Limitations of Process Layout**

(i) There are long material flow lines and hence the expensive handling is required.

(ii) Total production cycle time is more owing to long distances and waiting at various points.

(iii) Since more work is in queue and waiting for further operation hence bottle necks occur.

(iv) Generally, more floor area is required.

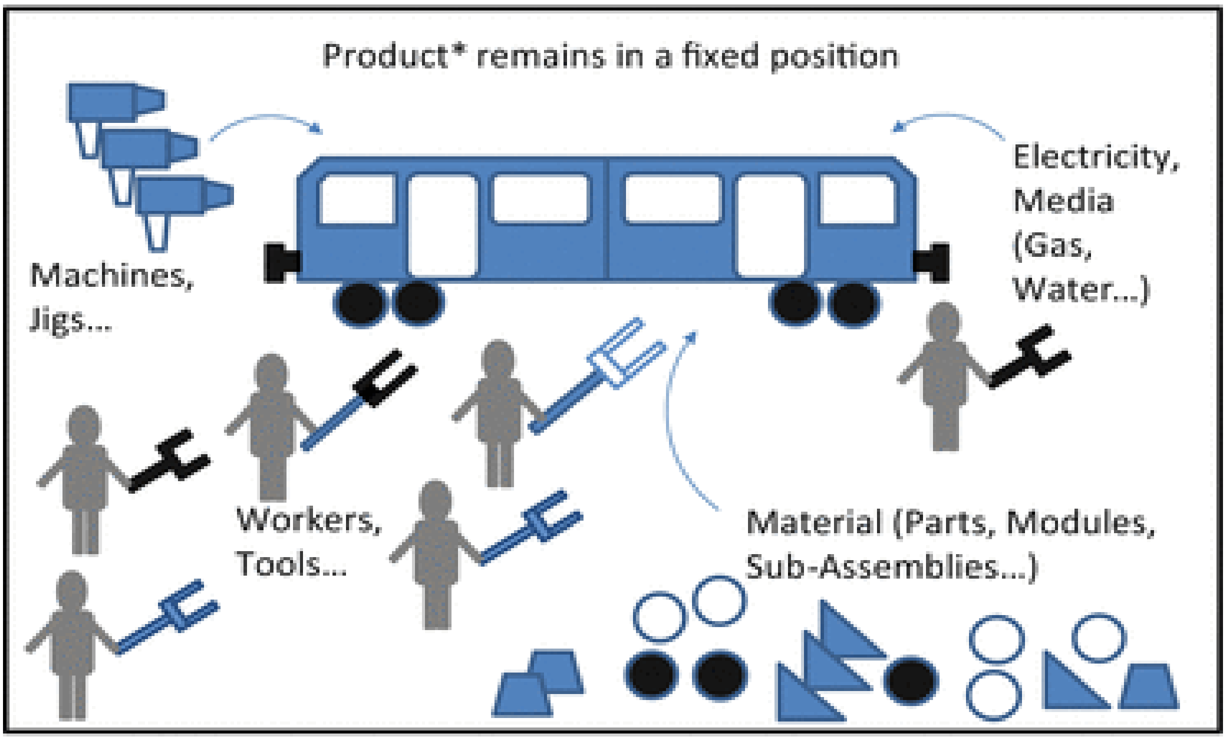
(v) Since work does not flow through definite lines, counting and scheduling is more tedious.

(vi) Specialization creates monotony and there will be difficult for the laid workers to find job in other industries.

### 3. Fixed Position Layout

This type of layout is the least important for today's manufacturing industries. In this type of layout the major component remain in a fixed location, other materials, parts, tools, machinery, man power and other supporting equipment's are brought to this location.

The major component or body of the product remain in a fixed position because it is too heavy or too big and as such it is economical and convenient to bring the necessary tools and equipment's to work place along with the man power. This type of layout is used in the manufacture of boilers, hydraulic and steam turbines and ships etc.



## Fixed-position layout

In a fixed-position layout, the workers and equipment come to the product. A fixed-position layout is used when it is not feasible to move the product (for example, because of its size, shape or dangerous composition). Examples include aircraft manufacturing and household electrical repairs.

**Advantages Offered by Fixed Position Layout**

(i) Material movement is reduced

(ii) Capital investment is minimized.

(iii) The task is usually done by gang of operators, hence continuity of operations is ensured

(iv) Productioncenters are independent of each other. Hence, effective planning and loading can be made. Thus total production cost will be reduced.

(v) It offers greater flexibility and allows change in product design, product mix and production volume.

**Limitations of Fixed Position Layout**

(i) Highly skilled man power is required.

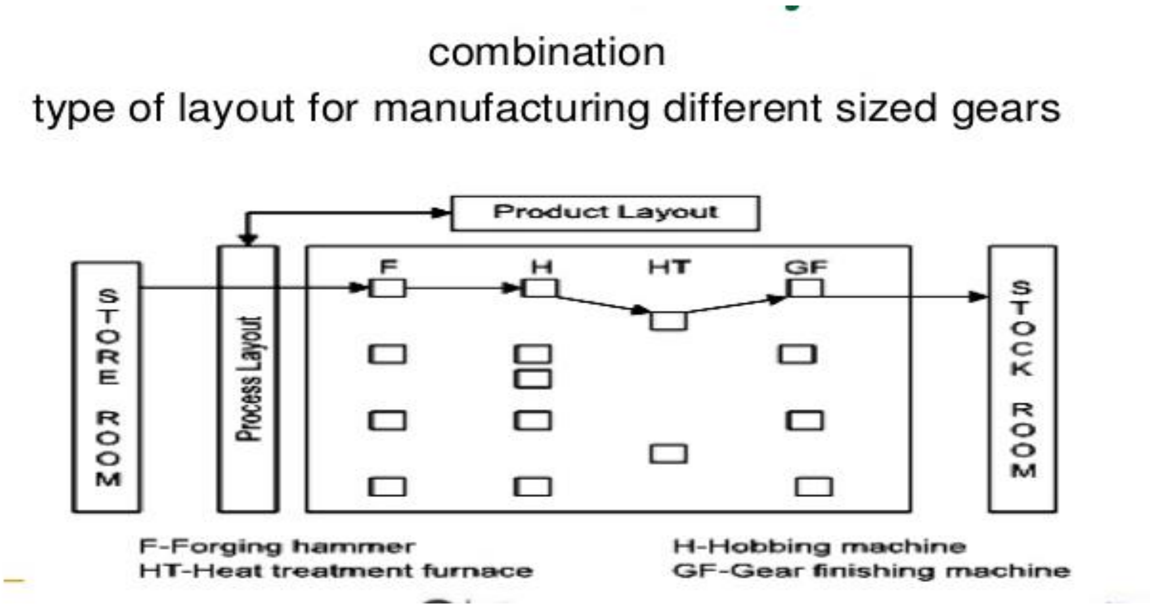
(ii) Movement of machines equipment’s to production centre may be time consuming.

(iii) Complicated fixtures may be required for positioning of jobs and tools. This may increase the cost of production.

4. **Combination Type of Layout**

Now a days in pure state any one form of layouts discussed above is rarely found. Therefore, generally the layouts used in industries are the compromise of the above mentioned layouts. Every layout has got certain advantages and limitations. Therefore, industries would to like use any type of layout as such.

Flexibility is a very important factory, so layout should be such which can be molded according to the requirements of industry, without much investment. If the good features of all types of layouts are connected, a compromise solution can be obtained which will be more economical and flexible.




## Size of Business unit

***1. Entrepreneurial Skill:***

The most important factor of comes is the skill, initiative and resourcefulness of the entrepreneur. Everything depends on his judgment and ability. An entrepreneur of outstanding ability will be able to procure as much finance as he may need, hire the requisite labor force and build up a huge business. But an entrepreneur of moderate ability will run business on a moderate scale and a man of limited entrepreneurial skill will be content with a small business

***2. Managerial Ability:***

For running the routine part of the business, managers are appointed. If a firm is lucky enough to have a manager of great ability, the size of the firm will grow to considerable dimensions. On the other hand, a mediocre manager will have a small-sized firm to manage.

***3. Availability of Finance:***

It is finance which oils the wheels of business machine. If ample funds are available, it will help the entrepreneur to make his business grow to a big size. This requires a proper development, of the banking system so that savings of the community can be effectively mobilized and utilized in the development of trade and industry.

***4. Availability of Labour:***

Another factor on which the size of the firm depends is the availability of labour of requisite skill. After all, what can the entrepreneur even with large capital do, if the labour to man the business is not available? What is required is efficient and skilled labour.

***5. Nature of Business:***

Much also depends on the nature of business. If the business obeys the law of increasing Returns, it will grow to a big size, otherwise, in the case of diminishing returns it will remain stunted, and in the case of constant returns it will remain stagnant.

***6. Extent of the Market:***

The size of the firm also depends on the extent of the market. If the commodity in which the firm deals or which it-manufactures has a wide market, naturally the business will assume a large scale. But if the demand for the commodity is fitful or limited, the size of the firm will continue to be small. These are some of the factors on which the size of an average firm in a country depends.

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SCHOOL OF MANAGEMENT STUDIES

# UNIT III - BUSINESS ORGANISATION – SBAA 1104

## Forms of Business Organisation

**Introduction** A business enterprises is an organisation which is engaged in some business or commercial activity. Every business enterprises is a separate and distinct unit of business.

**Various forms of business organisation from which one can choose the right one include**

- Sole Proprietorship
- Partnership
- Joint Stock Companies
- Co-operative Societies

### Sole Proprietorship

The vast majority of small businesses start out as sole proprietorships. These firms are owned by one person, usually the individual who has day-to-day responsibility for running the business. Sole proprietorships own all the assets of the business and the profits generated by it. They also assume complete responsibility for any of its liabilities or debts. In the eyes of the law and the public, you are one in the same with the business.

### Advantages

- Easiest and least expensive form of ownership to organize.
- Sole proprietors are in complete control, and within the parameters of the law, may make decisions as they see fit.
- Profits from the business flow-through directly to the owner's personal tax return.
- The business is easy to dissolve, if desired.

### Disadvantages

- Sole proprietors have unlimited liability and are legally responsible for all debts against the business. Their business and personal assets are at risk.
- May be at a disadvantage in raising funds and are often limited to using funds from personal savings or consumer loans.
- May have a hard time attracting high-caliber employees, or those that are motivated by the opportunity to own a part of the business.
- Some employee benefits such as owner's medical insurance premiums are not directly deductible from business income (only partially as an adjustment to income).

**Partnership**

**Meaning of Partnership**

A partnership is a kind of business where a formal agreement between two or more people is made and agreed to be the co-owners, distribute responsibilities for running an organization and share the income or losses that the business generates.

In India, all the aspects and functions of the partnership are administered under 'The Indian Partnership Act 1932'. This specific law explains that partnership is an association between two or more individuals or parties who have accepted to share the profits generated from the business under the supervision of all the members or behalf of other members.

# Features of Partnership:

Following are the few features of a partnership:

**1. Agreement between Partners:** It is an association of two or more individuals, and a partnership arises from an agreement or a contract. The agreement (accord) becomes the basis of the association between the partners. Such an agreement is in the written form. An oral agreement is even-handedly legitimate. In order to avoid controversies, it is always good, if the partners have a copy of the written agreement.
**2. Two or More Persons:** In order to manifest a partnership, there should be at least two (2) persons possessing a common goal. To put it in other words, the minimal number of partners in an enterprise can be two (2). However, there is a constraint on their maximum number of people.
**3. Sharing of Profit:** Another significant component of the partnership is, the accord between partners has to share gains and losses of a trading concern. However, the definition held in the Partnership Act elucidates – partnership as an association between people who have consented to share the gains of a business, the sharing of loss is implicit. Hence, sharing of gains and losses is vital.
**4. Business Motive:** It is important for a firm to carry some kind of business and should have a profit gaining motive.
**5. Mutual Business:** The partners are the owners as well as the agent of their firm. Any act performed by one partner can affect other partners and the firm. It can be concluded that this point act as a test of partnership for all the partners.

**6. Unlimited Liability:** Every partner in a partnership has unlimited liability.

**Advantages**

- Partnerships are relatively easy to establish; however time should be invested in developing the partnership agreement.
- With more than one owner, the ability to raise funds may be increased.
- The profits from the business flow directly through to the partners' personal tax return.
- Prospective employees may be attracted to the business if given the incentive to become a partner.
- The business usually will benefit from partners who have complementary skills.

**Disadvantages**

- Partners are jointly and individually liable for the actions of the other partners.
- Profits must be shared with others.
- Since decisions are shared, disagreements can occur.
- Some employee benefits are not deductible from business income on tax returns.
- The partnership may have a limited life; it may end upon the withdrawal or death of a partner.

<u>Types of Partnerships .</u>

There are three relatively common partnership types: general partnership, limited partnership (LP) and limited liability partnership.

*1. General Partnership:*

General partnership is a simple partnership and many times referred as Partnership Firm. A general partnership is a business entity that is made up of two or more entities to carry on a trade or business. Each partner contributes money, property, labor, or special skills and each partner shares in the profits and losses from the business.

The law also allows the partners of a general partnership firm to sue or to be sued in the name of firm (only applicable for registered firms), though registration is optional.

*2. Limited Partnership:*

A limited partnership includes both general partners and limited partners. A limited partner does not participate in the day-to-day management of the partnership and his/her liability is limited. In many cases, the limited partners are merely investors who do not wish to participate in the partnership other than to provide an investment and to receive a share of the profits.

*3. Limited Liability Partnership:*

A limited liability partnership (LLP) is a form of partnership in which, Individual partners are not personally responsible for the wrongful acts of other partners, or for the debts or obligations of the business. Specifically, a limited liability partnership can only be sued for the total amount of assets in the business.

Owing to flexibility in its structure and operation, it would be useful for small and medium enterprises, in general, and for the enterprises in services sector, in particular. Internationally, LLPs are the preferred vehicle of business, particularly for service industry or for activities involving professionals. LLP is a separate legal entity; means LLP and Partners are distinct from each other. Minimum two partners are required for starting LLP but there is no limit for maximum numbers of partners.

**Example:**

If a customer slipped on a pickle in your grocery store and is suing for their injuries, they cannot receive more than the total value of your grocery store. This partnership is a popular choice for law firms and medical practices to ensure that customers cannot sue for assets such as the practitioner's home.

**Advantages of Limited Liability Partnership:**

i. Low cost of Formation and Easy to establish.

ii. Easy to manage and run.

iii. No restrictions as to maximum number of partners.

iv. LLP and its partners are distinct from each other.

v. Partners are not liable for Act of partners.

vi. Less Government Intervention and Easy to dissolve or wind-up.

vii. Audit requirement only in case of contributions exceeding Rs 25 lakh or turnover exceeding Rs 40 lakh.

**Disadvantages of Limited Liability Partnership:**

i. Any act of the partner without the other partner, may bind the LLP.

ii. Under some cases, liability may extend to personal assets of partners.

iii. Cannot raise money from Public.

*4. Public Private Partnership:*

Public Private Partnership means an arrangement between a government/statutory entity/government owned entity on one side and a private sector entity on the other, for the provision of public assets and/or public services, through investments being made and/or management being undertaken by the private sector entity, for a specified period of time, where there is well defined allocation of risk between the private sector and the public entity and the private entity receives performance linked payments that conform (or are benchmarked) to specified and pre-determined performance standards, measurable by the public entity or its representative. These schemes are sometimes referred to as PPP, P3 or P3.

“Public Private Partnership (PPP) is a partnership between the public and private sector for the purpose of delivering a project or service traditionally provided by the public sector. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares in the risks and rewards potential in the delivery of the service and/or facility”.

“Public Private Partnerships (PPPs) are arrangements between government and private sector entities for the purpose of providing public infrastructure, community facilities and related services. Such partnerships are characterized by the sharing of investment, risk, responsibility and reward between the partners. The reasons for establishing such partnerships vary but generally involve the financing, design, construction, operation and maintenance of public infrastructure and services.”

**Example:**

Gurgaon is a good example of large scale public-private participation in urban development in India, The Uttaranchal Mobile Hospital and Research Center (UMHRC) (Technology Information, Forecasting and Assessment Council (TIFAC), the Government of Uttaranchal and the Birla Institute of Scientific Research (BISR)) and HPCL-Mittal Energy partnership.

(C) **Joint Stock Companies**

Features of a Joint Stock Company

**1) Artificial Legal Person**

A company is a legal entity that has been created by the statues of law. Like a natural person, it can do certain things, like own property in its name, enter into a contract, borrow and lend money, sue or be sued, etc. It has also been granted certain rights by the law which it enjoys through its board of directors.

However, not all laws/rights/duties apply to a company. It exists only in the law and not in any physical form. So we call it an artificial legal person.

**2) Separate Legal Entity**

Unlike a proprietorship or partnership, the legal identity of a company and its members are separate. As soon as the joint stock company is incorporated it has its own distinct legal identity. So a member of the company is not liable for the company. And similarly, the company will not depend on any of its members for any business activities.

**3) Incorporation**

For a company to be recognized as a separate legal entity and for it to come into existence, it has to be incorporated. Not registering a joint stock company is not an option. Without incorporation, a company simply does not exist.

**4) Perpetual Succession**

The joint stock company is born out of the law, so the only way for the company to end is by the functioning of law. So the life of a company is in no way related to the life of its members. Members or shareholders of a company keep changing, but this does not affect the company’s life.

**5) Limited Liability**

This is one of the major points of difference between a company and a sole proprietorship and partnership. The liability of the shareholders of a company is limited. The personal assets of a member cannot be liquidated to repay the debts of a company.

A shareholders liability is limited to the amount of unpaid share capital. If his shares are fully paid then he has no liability. The amount of debt has no bearing on this. Only the companies assets can be sold off to repay its own debt. The members cannot be made to pay up.

**6) Common Seal**

A company is an artificial person. So its day-to-day functions are conducted by the board of directors. So when a company enters any contract or signs an agreement, the approval is indicated via a common seal. A common seal is engraved seal with the company's name on it.

So no document is legally binding on the company until and unless it has a common seal along with the signatures of the directors.

**7) Transferability of Shares**

In a joint stock company, the ownership is divided into transferable units known as shares. In case of a public company the shares can be transferred freely, there are almost no restrictions. And in a public company, there are some restrictions, but the transfer cannot be prohibited.

**<u>Advantages</u>**

- One of the biggest drawing factors of a joint stock company is the limited liability of its members. Their liability is only limited up to the unpaid amount on their shares. Since their personal wealth is safe, they are encouraged to invest in joint stock companies
- The shares of a company are transferable. Also, in the case of a listed public company they can also be sold in the market and be converted to cash. This ease of ownership is an added benefit.
- Perpetual succession is another advantage of a joint stock company. The death/retirement/insanity/etc does affect the life of a company. The only liquidation under the Companies Act will shut down a company.
- A company hires a board of directors to run all the activities. Very proficient, talented people are elected to the board and this results in effective and efficient management. Also, a company usually has large resources and this allows them to hire the best talent and professionals.

**<u>Disadvantages</u>**

- One disadvantage of a joint stock company is the complex and lengthy procedure for its formation. This can take up to several weeks and is a costly affair as well.
- According to the Companies Act, 2013 all public companies have to provide their financial records and other related documents to the registrar. These documents are then public documents, which any member of the public can access. This leads to a complete lack of secrecy for the company.
- And even during its day to day functioning a company has to follow a numerous number of laws, regulations, notifications, etc. It not only takes up time but also reduces the freedom of a company
- A company has many stakeholders like the shareholders, the promoters, the board of directors, the employees. the debenture holders etc. All these stakeholders look out for their benefit and it often leads to a conflict of interest.

**Types of Companies**
A) On the basis of incorporation:

**On the basis of incorporation, companies can be classified as:**

(i) Chartered companies

(ii) Statutory companies

(iii) Registered companies

***(i) Chartered companies:***

The crown in exercise of the royal prerogative has power to create a corporation by the grant of a charter to persons assenting to be incorporated. Such companies or corporations are known as chartered companies. Examples of this type of companies are Bank of England (1694), East India Company (1600). The powers and the nature of business of a chartered company are defined by the charter which incorporates it. After the country attained independence, these types of companies do not exist in India.

***(ii) Statutory companies:***

A company may be incorporated by means of a special Act of the Parliament or any state legislature. Such companies are called statutory companies, Instances of statutory companies in India are Reserve Bank of India, the Life Insurance Corporation of India, the Food Corporation of India etc. The provisions of the Companies Act 1956 apply to statutory companies except where the said provisions are inconsistent with the provisions of the Act creating them. Statutory companies are mostly invested with compulsory powers.

***(iii) Registered companies:***

Companies registered under the Companies Act 1956, or earlier Companies Acts are called registered companies. Such companies come into existence when they are registered under the Companies Act and a certificate of incorporation is granted to them by the Registrar.

(B) On the basis of liability:

**On the basis of liability the company can be classified into:**

i) Companies limited by shares

(ii) Companies limited by guarantee

(iii) Unlimited companies.

***(i) Companies limited by shares:***

When the liability of the members of a company is limited to the amount if any unpaid on the shares, such a company is known as a company limited by shares. In a company limited by shares the liability of the members is limited to the amount if any unpaid on the shares respectively held by them. The liability can be enforced during existence of the company as well as during the winding up. Where the shares are fully paid up, no further liability rests on them.

***(ii) Companies limited by guarantee:***

It is a registered company in which the liability of members is limited to such amounts as they may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. In the case of such companies the liability of its members is limited to the amount of guarantee undertaken by them. Clubs, trade associations, research associations and societies for promoting various objects are various examples of guarantee companies.

***(iii) Unlimited companies:***

A company not having a limit on the liability of its members is termed as unlimited company. In case of such a company every member is liable for the debts of the company as in an ordinary partnership in proportion to his interest in the company. Such companies are not popular in India.

<u>(C) On the basis of number of members:</u>

***(i) Private company:***

**A private company means a company which by its articles of association:**

(i) Restricts the right to transfer its shares

(ii) Limits the number of its members to fifty (excluding members who are or were in the employment of the company) and

(iii) Prohibits any invitation to the public to subscribe for any shares or debentures of the company.

(iv) Where two or more persons hold one or more shares in a company jointly, they are treated as a single member. There should be at least two persons to form a private company and the maximum number of members in a private company cannot exceed 50. A private limited company is required to add the words “Private Ltd” at the end of its name.

Ex: ABC Private Limited/ABC PVT. Limited/ABC (P) Limited

***(ii) Public company:***

public company means a company which is not a private company. There must be at least seven persons to form a public company. It is of the essence of a public company that its articles do not contain provisions restricting the number of its members or excluding generally the transfer of its shares to the public or prohibiting any invitation to the public to subscribe for its shares or debentures. Only the shares of a public company are capable of being dealt in on a stock exchange.

Ex: Reliance Industries Limited/Tata Consultancy Services Limited

(D) According to Domicile:

***(i) Foreign company:***

It means a company incorporated outside India and having a place of business in India.

**According to Section 591 a foreign company is one incorporated outside India:**

(a) Which established a place of business within India after the commencement of this Act or
(b) Which had a place of business within India before the commencement of this Act and continues to have the same at the commencement of this Act.

***(ii) Indian Companies:***

A company formed and registered in India is known as an Indian Company.

(E) Miscellaneous Category:

***(i) Government Company:***

It means any company in which not less than 51 percent of the paid up share capital is held by the Central Govt, and/or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments. The subsidiary of a Government company is also a Government company.

Ex: NLC India Limited/BSNL/ONGC/BEML/BHEL

***(ii) Holding and subsidiary companies:***

A company is known as the holding company of another company if it has control over another company. A company is known as subsidiary of another company when control is exercised by the latter over the former called a subsidiary company. A company is to be deemed to be subsidiary company of another .

**(a) If the other:**

(a) Controls the composition of its Board of directors or

(b) Exercises or controls more than half of its total voting power where it is an existing company in respect where of the holders of preference shares issued before the commencement of the Act have the same voting rights as the holders of equity shares or

(c) In the case of any other company holds more than half in nominal value of its equity share capital or

**(b)** If it is a subsidiary of a third company which is subsidiary of the controlling company.

***(iii) One man Company:***

This is a company in which one man holds practically the whole of the share capital of the company and in order to meet the statutory requirement of minimum number of members, some dummy members hold one or two shares each. The dummy members are usually nominees of principal shareholder. The principal shareholder is in a position to enjoy the profits of the business with limited liability. Such type of companies are perfectly valid and not illegal.

**Co-operatives**

**A cooperative society** is not a new concept. It prevails in all the countries, this is almost a universal concept. The cooperative society is active in all countries worldwide and is represented in all the sectors including agriculture, food, finance, healthcare, etc.

To protect the interest of weaker sections, the co-operative society is formed. It is a voluntary association of persons, whose motive is the welfare of the members.

Types of Cooperative Society

**1) Producer Cooperative**

To protect the interest of small producers, these societies are set up. The co-operative society members may be farmers, landowners, owners of the fishing operations. To increase the marketing possibilities and production efficiency, producers decide to work together or as separate entities.

They perform several activities like processing, marketing & distributing their own products. This helps in lower costs and strains in each area with a mutual benefit to each producer.

**2) Consumer Cooperative**

These businesses are owned and governed by consumers of a particular area for their mutual benefit. Their view is to provide daily necessary commodities at an optimum price. Rather than earning a pecuniary profit, their aim is towards providing service to the consumers.

**3) Credit Unions**

Credit unions are generally member-owned financial cooperatives. Their principle is of people helping people. They provide credit and financial services to the members at competitive prices. Each and every depositor has the right to become a member. Members attend the annual meeting and are given rights to elect a board of directors.

**4) Marketing Cooperative Society**

With an aim of helping small producers in selling their products, these societies are established. The producers who wish to obtain reasonable prices for their output are the members of this society.

For securing a favourable market for the products they eliminate the middlemen and improve the competitive position of its members. It collects the output of individual members. Various marketing functions like transportation, packaging, warehousing, etc are performed by the cooperative societies to sell the product at the best possible price.

**5) Housing Cooperative Society**

To help people with limited income to construct houses at reasonable costs, these societies are established. Their aim is to solve the housing problems of the members. A member of this society aims to procure the residential house at lower cost.

They construct the houses and give the option to members to pay in installments to purchase the house. They construct flats or provide plots to members on which the members themselves can construct the houses as per their choice.

Features

- As it is a voluntary association, the membership is also voluntary. A person is free to join a cooperative society, and can also leave anytime as per his desire. Irrespective of their religion, gender & caste, membership is open to all.
- It is compulsory for the co-operative society to get registration. The co-operative society is a separate legal identity to the society.
- It does not get affected by the entry or exit of its members.
- There is limited liability of the members of co-operative society. Liability is limited to the extent of the amount contributed by members as capital.
- An elected managing committee has the powers to take decisions. Members have the right to vote, by which they elect the members who will constitute the managing committee.
- The cooperative society works on the principle of mutual help & welfare. Hence, the principal of service dominates it’s working. If any surplus is generated, it is distributed amongst the members as a dividend in conformity with the bye-laws of the society.

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SCHOOL OF MANAGEMENT STUDIES

# UNIT IV - BUSINESS ORGANISATION – SBAA 1104

## Business Combination:

### Meaning, Causes

**Business combinations** are combinations formed by two or more business units, with a view to achieving certain common objective (specially elimination of competition); such combinations ranging from loosest combination through associations to fastest combinations through complete consolidations.

**L.H. Haney defines a combination as follows:**

**"To combine is simply to become one of the parts of a whole; and a combination is merely a union of persons, to make a whole or group for the prosecution of some common purposes."**

### Causes of Business Combinations:

1. Elimination of Cutthroat Competition

Large-scale production and intense competition have become the rule of the present day economy. Cutthroat competition leads to wasteful advertising, unnecessary duplication, over production etc., which all ultimately result in lowering the profit margin of the industrialists. Under such circumstances, small units could not survive. Therefore, the only alternative available to the industrialists is the elimination of competition, which could be possible only through business combination.

2. Economies of Large-scale Production

Large-sale production has certain definite advantages. If different firms come together and form amalgamations, the scale of operation also become larger and savings in overhead charges can be effected.

3. Influence of Tariff

The tariff policies of different countries have also furthered the causes of the combination movement. Tariff is often described as the "*Mother of Combination*". By imposing high tariff on imported goods, the Governments throughout the world offered protection to home industries. The protection offered by the state resulted in the establishment of a number of business units. Consequently, competition amongst them became tense and the need for business combination was felt.

4. Transport Revolution

Another contributory cause for the combination movement was the revolution in transport and development of communications. The development of transport facilities accelerated the growth of large-scale undertakings. The large undertakings began to absorb smaller units to cater to the needs of the local market.

5. Organizational Revolution

The growth of joint stock companies has also facilitated combinations. Basically the company form of organization itself is a type of combination. Large companies with huge capital were able to control comparatively small companies by subscribing to their shares. Hence, holding companies came into being.

6. Control of the Market

Another important cause for the rise of the combination movement was the desire to control the market by regulating the output. This goal could be achieved only through business combination.

7. Trade Cycles

The tendency of business activities to fluctuate regularly between booms and depressions gave a fillip to business combinations. Particularly during the periods of depression, new units cannot enter into the industry and even the existing small and inefficient units cannot survive.

During 1930, when the Great Depression occurred, the situation became very awkward and the industrialists began to adopt the technique of business combination.

8. Technological Factors

The technological development also paved way for large-scale operations. Small units with limited financial resources were found unable to compete with bigger ones. Hence, they realized the need for business combination.

Moreover, the adoption of modern techniques required huge capital investments, which small units could not provide. Therefore, they were forced to combine themselves to get the benefits of modernization.

9. Patent Laws

Business Combination has also been fostered by patent laws. The inventors were given exclusive right of the use of their inventions. This statutory right also furthered the combination movement.

10. Individual Ability

Men of technical skill of a superior order are less in number. The scarcity of business talent is also a cause for the centralization of powers in the hands of a few. Many combines have common directors, managers, which in effect would mean their common control.

11. Policies of the Government

The labour, fiscal, industrial and taxation policies of the Governments also influenced the formation of business combinations. The Government may even exert pressure on weaker units to merge with bigger ones.

Frequent changes in the policies of the Government also increased the uncertainty among the businessmen. The instability of the economic policies also encouraged the growth of the combination movement.

12. Rationalization

In fact, combination is the first step towards rationalization. The growth of rationalization movement encouraged the emergence of business combinations to a great extent.

13. Cut of the Colossal

The mid-nineteenth century brought in its wake the cult of the colossal-respect for bigness. People began to respect big things and there was a corresponding contempt for small things. The impact of this tendency was felt in the business field also. The glamour for giant undertakings captured the minds of the industrialists. This tendency also furthered the combination movement.

**Business Combination: Objectives**

The basic objective of combinations is the sustained profitable growth of the combining enterprises. This basic objective is realized by achieving economies of scale, reducing competition, preventing the entry of new firms and controlling the market.

**The objectives of combinations are:**

1. Achieving sustained growth and profits.
2. Reduction in competition.
3. Preventing the entry of new firms by creating entry barriers.
4. Achieving monopoly status.
5. Undertaking large scale production and benefiting from economies of scale.
6. Investing in common facilities and infrastructure.
7. Avoiding cut-throat competition and the evils associated with it.
8. Achieving greater financial strength and stability.
9. Investing in research and development to innovate new products.
10. Pooling of material and manpower to ensure efficiency in operations.
11. Sharing knowledge of best practices for mutual benefit.
12. Maintaining stability in prices.
13. To withstand the effects of business cycles.

**Business Combination: Types and Forms**

(i) Horizontal Combinations.

It refers to combination of businesses engaged in the production of the same type of product or engaged in the same trade. For e.g. Cement companies joining together (acquisition of Gujarat Ambuja Cement by Lafarge of France) or steel manufacturers joining together (Tata Iron and Steel Co., acquiring Natsteel of Singapore) etc. It is also known as parallel or unit or trade combination.

Advantages of Horizontal combination in business

The following are the advantages of horizontal combinations:

1. Avoidance of wasteful competition.

2. It ensures better control over markets.

3. It helps realize economies of scale.

4. It aids standardization of products.

Disadvantages of horizontal combination in business

The following are the disadvantages of horizontal combinations:

1. It may lead to monopoly situations.

2. It may result in restriction of output, increase in prices and exploitation of consumers.

3. When the business grows beyond a particular size, control becomes difficult.

(ii) Vertical Combinations.

**(iii) Lateral or Allied Combinations:**

Lateral combination refers to the combination of those firms which manufacture different kinds of products; though they are allied in some way.

**Lateral combination may be:**

**(a) Convergent lateral combination:**

In convergent lateral combination, different industrial units which supply raw-materials to a major firm, combine together with the major firm. The best illustration is found in a printing press, which may combine with units engaged in supply of paper, ink, types, cardboard, printing machinery etc.

**(b) Divergent lateral combination:**

Divergent lateral integration takes place when a major firm supplies its product to other combing firms, which use it as their raw material. The best example of such combination may be found in a steel mill which supplies steel to a number of allied concerns for the manufacture of a variety of products like tubing, wires, nails, machinery, locomotives etc.

**(iv) Diagonal (or Service) Combinations:**

This type of combination takes place when a unit providing essential auxiliary goods / services to an industry is combined with a unit operating in the main line of production. Thus, if an industrial enterprise combines with a repairs workshop for maintaining tools and machines in good order; it will be effecting diagonal combination.

**(v) Circular (or Mixed) Combinations:**

When firms engaged in the manufacture of different types of products join together; it is known as circular or mixed combination. For example, if a sugar mill combines with a steel works and a cement factory; the result is a mixed combination.

***Forms of Business Combinations:***

By the phrase ‘forms of combinations’, we mean the degree of combination, among the combining business units.

**According to Haney, combinations may take the following forms, depending on the degree or fusion among combining firms:**

**(I) Associations:**

(i) Trade associations

(ii) Chambers of commerce

(iii) Informal agreements

**(II) Federations:**

(i) Pools

(ii) Cartels

**(III) Consolidations – Partial and Complete:**

**(a) Partial Consolidations:**

(i) Combination trusts

(ii) Community of interest

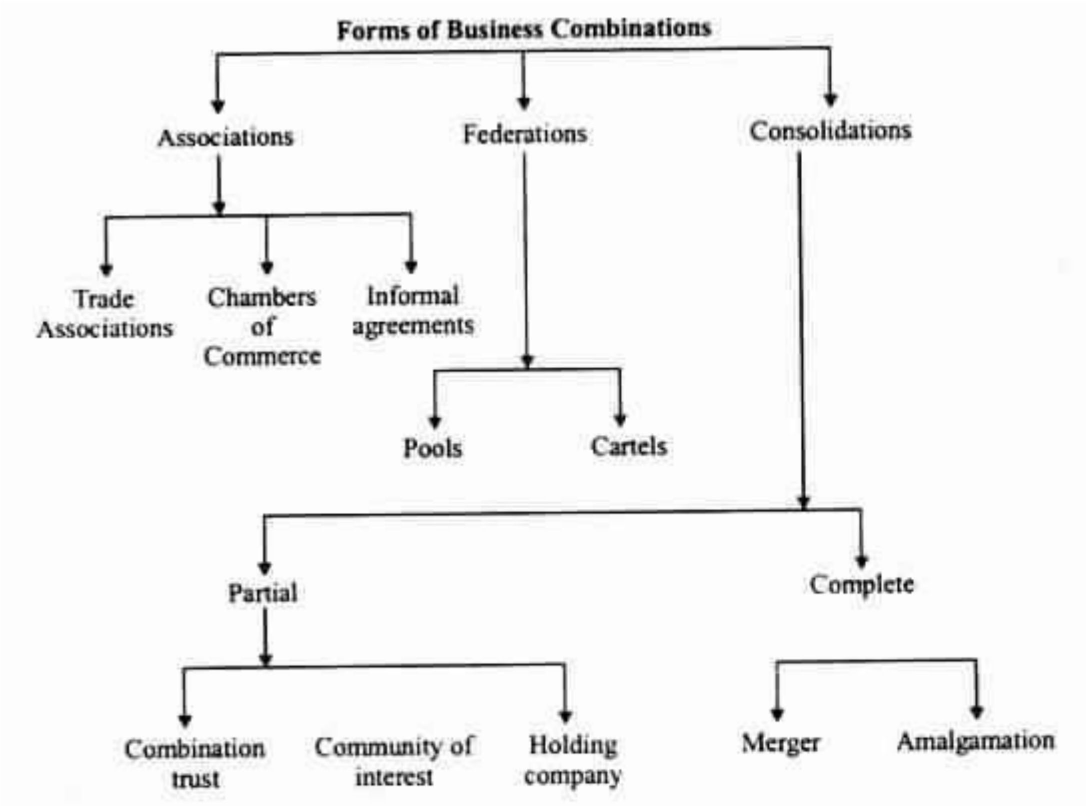
(iii) Holding company

**(b) Complete Consolidations:**

(i) Merger

(ii) Amalgamation

**The following chart depicts the above forms of business combinations:**




**(I) Associations:**

**Forms of Combinations, in this Category are:**

**(i) Trade Associations:**

A trade association comes into being when business units engaged in a particular trade or industry or in closely related trades come together for the promotion of their economic and business interests. Such an association is organized on a non-profit basis and its meetings are used largely for a discussion of matters affecting the common interests of members such as problems of raw- materials, labour, tax-laws etc.

**ii) Chambers of Commerce:**

Chambers of commerce is voluntary associations of persons connected with commerce and industry. Their membership consists of merchants, brokers, bankers, industrialists, financiers etc.

Chambers of commerce is formed in the same way as associations, with the ultimate objective of promoting and protecting the interests of business community. But they differ from trade associations in that they do not confine their interests only to a particular trade or industry; but stand for the business community in a particular region, country, or even the world, as a whole.

**(iii) Informal Agreements:**

Informal agreements among business magnates are often concluded secretly at social functions like dinners or at meetings of trade associations etc. These agreements are merely understanding among the parties and no written documents are prepared. As they depend mainly on the honour and sincerity of members; they are referred to as Gentlemen's agreements.

**(II) Federations:**

**Forms of Business Combinations in this Category are:**

**(i) Pools:**

Under the pool form of business combination, the members of a pooling agreement join together to regulate the demand or supply of a product without surrendering their separate entities, in order to control price.

**(ii) Cartels (Kartells):**

Basically cartel is the European name for the American pools. According to Von Beckereth, **"A cartel is a voluntary agreement of capitalistic enterprises of the same branch for a regulation of the sales market with a view to improving the profitableness of its members' business."**

**Mergers**

**A merger** is the combination of two companies into one by either closing the old entities into one new entity or by one company absorbing the other. In other words, two or more companies are consolidated into one company.

A **merger** is a combination of two corporations, as a result of which one loses its corporate entity. The surviving corporation acquires the liabilities, assets, personnel and much of the reputation of the fusing company.

A merger is fundamentally different from a statutory consolidation in the sense that it involves a combination of two companies, whereby an entirely new corporation is formed. Both the old companies cease to exist, and the share of their common stock are exchanged for shares in the new company.

Examples of Mergers

- Acquisition of Modern Foods, Kissan, Tata Oil Mills Co., Ltd (TOMCO), Kwality Walls etc., by Hindustan Level Limited(HLL).
- Acquisition of ANZ Grindlays Indian operations by Standard Chartered, Times Bank by HDFC Bank, Bank of Madura by ICICI Bank,
- Acquisition of Voltas and Allwyn by Electrolux. Subsequently Electrolux's – Indian operations were acquired by Videocon International.
- Recent international mergers include – acquisition of Gillette by P&G, Betapharma by Ranbaxy, IBM's PC division by Lenovo, Compaq by Hewlett Packard(HP) etc.

## Types of mergers

The following are the types of mergers

. **Horizontal mergers**: It refers to two firms operating in same industry or producing ideal products combining together. For e.g., in the banking industry in India, acquisition of Times Bank by HDFC Bank, Bank of Madura by ICICI Bank, Nedungadi Bank by Punjab National Bank etc. in consumer electronics, acquisition of Electrolux's Indian operations by Videocon International Ltd., in BPO sector, acquisition of Daksh by IBM, Spectramind by Wipro etc. The main objectives of horizontal mergers are to benefit from economies of scale, reduce competition, achieve monopoly status and control the market.

2. **Vertical merger**: A vertical merger can happen in two ways. One is when a firm acquires another firm which produces raw materials used by it. For e.g., a tyre manufacturer acquires a rubber manufacturer, a car manufacturer acquires a steel company, a textile company acquires a cotton yarn manufacturer etc.

Another form of vertical merger happens when a firm acquires another firm which would help it get closer to the customer. For e.g., a consumer durable manufacturer acquiring a consumer durable dealer, an FMCG company acquiring m advertising company or a retailing outlet etc.

3. **Conglomerate merger**: It refers to the combination of two firms operating in industries unrelated to each other. In this case, the business of the target company is entirely different from those of the acquiring company. For e.g., a watch manufacturer acquiring a cement manufacturer, a steel manufacturer acquiring a software company etc. The main objective of a conglomerate merger is to achieve i big size.

4. **Concentric merger**: It refers to combination of two or more firms which are related to each other in terms of customer groups, functions or technology. For eg., combination of a computer system manufacturer with a UPS manufacturer.

5. **Forward merger**: In a forward merger, the target merges into the buyer. For e.g., when ICICI Bank acquired Bank of Madura, Bank of Madura which was the target, merged with the acquirer, ICICI Bank.

6. **Reverse merger**: In this case, the buyer merges into the target and the shareholders of the buyer get stock in the target. This is treated as a stock acquisition by the buyer.

7. **Subsidiary merger**: A subsidiary merger is said to occur when the buyer sets up an acquisition subsidiary which merges into the target.

**Takeovers**

A takeover (or acquisition) involves one business acquiring control of another business

Takeovers (or acquisitions as they are otherwise known) are the most common form of external growth, particularly by larger businesses.

Reasons for Takeovers

There are many reasons why a firm may decide to undertake a takeover as part of its strategy, including to:

- Increase market share
- Acquire new skills
- Access economies of scale
- Secure better distribution
- Acquire intangible assets (brands, patents, trade marks)
- Spread risks by diversifying
- Overcome barriers to entry to target markets
- Defend itself against a takeover threat
- Enter new segments of an existing market
- Eliminate competition

**Possible strategic reasons why takeovers might be the best option for a business include:**

- Existing products are in the later stages of their life cycles, making it hard to grow organically
- The business (in particularly its management) lacks expertise or resources to develop organically
- Speed of growth is a high priority
- Competitors enjoy significant advantages that are hard to overcome other than acquiring them!

**The Risks and Drawbacks of Takeovers**

It is important to recognise that takeovers are the highest risk method of growth.

Many studies on the performance of takeovers have been completed over the years and they consistently show that a large percentage of takeovers destroy value for the shareholders of the acquiring firm (in other words – most takeovers fail).

**Why Takeovers Fail**

- Among the main reasons why so many takeovers fail are:
- Price paid for takeover was too high (over-estimate of synergies)
- Lack of decisive change management in the early stages

- The takeover was mishandled
- Cultural incompatibility between the two businesses
- Poor communication, particularly with management, employees and other stakeholders of the acquired business
- Loss of key personnel & customers post acquisition
- Competitors take the opportunity to gain market share whilst the takeover target is being integrated.

**The common drawbacks of takeovers include:**

- High cost involved – with the takeover price often proving too high
- Problems of valuation (see the price too high, above)
- Upset customers and suppliers, usually as a result of the disruption involved
- Problems of integration (change management), including resistance from employees
- Incompatibility of management styles, structures and culture
- Questionable motives

Types of Takeovers

- **Reverse Takeover-** Reverse takeovers or Bail Out takeover is a type of acquisition that helps the managers of private companies to attain a public company status without resorting to an (IPO) Initial Public Offering.
- **Friendly Takeover-** Under this type of takeover, the acquirer company notifies its Board of Directors about the acquisition offer before making a direct offer to the target company. Thereon, the acquired company take the consent of the Directors & shareholders of the target company to have a friendly takeover.
- **Hostile Takeover-** A hostile takeover is a forced method of acquiring the target company. In such an acquisition, the management of the target company does not agree for the merger or is reluctant to for takeover. A takeover is referred to as hostile, if the board of the target company rejects the acquisition offer, but the acquirer continues to pursue it.

**Key difference between Takeover and Merger**

| **Sr. No** | **Terms of Differences** | **Takeover** | **Merger** |
|---|---|---|---|
| 1 | Number of Entities Involved | Minimum 2 companies are required in which one company takes over the shares or assets of the other company. | Minimum 2 companies are required for a merger wherein two companies merge together as one. |
| 2 | Size of the Companies | Different sizes of companies are involved where the larger company | Both companies are equal in size. |

| | | | |
|---|---|---|---|
| | | takeovers smaller companies. | |
| 3 | Transfer of Shares | The acquirer company purchases or takeover more than 50% shares of the target company. | Shares of the absorbing company are given to the shareholder of the absorbed company. |
| 4 | Terms | Company takeover can be friendly or hostile. | A merger is usually voluntarily or friendly. |
| 5 | Consolidation | Takeover is driven by the acquirer company with or without the consent of the acquired company. | Merger is often driven by the absorbing company. |
| 6 | Accounting Treatment | The acquirer company takes over all the assets and liabilities of the target company. | The assets and liabilities of both the companies are merged and consolidated |

**Acquisitions**

**An acquisition** is defined as a corporate transaction where one company purchases a portion or all of another company's shares or assets. Acquisitions are typically made in order to take control and build on the target company's weaknesses or strengths and capture synergies. There are several types of business combinations: acquisitions (both companies survive), mergers (one company survives), and amalgamations (neither company survives).

The acquiring company will buy the shares of the assets of the target company, which gives the acquiring company the powers to make decisions concerning the acquired assets without needing the approval of shareholders from the target company.

<u>Benefits of Acquisitions</u>

***1. Reduced entry barriers***

With M&A, a company is able to enter into new markets and product lines instantaneously with a brand that is already recognized, with a good reputation and an existing client base. An acquisition can help to overcome market entry barriers that were previously challenging and also reduce the risks of adverse reactions by competitors. Market entry can be a costly scheme for small businesses due to expenses in market research, development of a new product, and the time needed to build a substantial client base.

***2. Market power***

An acquisition will help to increase the market share of your company quickly and reduce the competition's stronghold. Even though competition can be challenging, growth through acquisition can be helpful in reducing the capacity of competitors and making things even. The process helps achieves market synergies.

***3. New competencies and resources***

A company can choose to take over other businesses to gain competencies and resources it does not hold currently. They can provide many benefits, such as rapid growth in revenues or an improvement in the long-term financial position of the company, which makes it raising capital for growth strategies easier. Expansion and diversity can also help a company to withstand an economic slump.

***4. Access to experts***

When small businesses join with larger businesses, they are able to access specialists such as financial, legal or human resource specialists.

***5. Access to capital***

After an acquisition, access to capital as a larger company is improved. Small business owners are usually forced to invest their own money in business growth due to the inability to access funds. However, with an acquisition, there is an availability of a greater level of capital, enabling business owners to acquire funds needed without the need to dip into their own pockets.

***6. Fresh ideas and perspective***

M&A helps put together a new team of experts with fresh perspectives and ideas and who are passionate about helping the business reach its goals.

Challenges with Acquisitions

M&A can be a good way to grow your business by increasing your revenues when you acquire a complimentary company that is able to contribute to your income. Nevertheless, M&A deals can also create some hitches and disadvantage your business. You must put these pitfalls into consideration before pursuing an acquisition.

***1. Culture clashes***

A company usually has its own distinct culture that has been developing since its inception. Acquiring a company that has a culture that conflicts with yours can be problematic. Employees and managers from both companies, as well as their activities, may not integrate as well as anticipated. Employees may also dislike the move, which may breed antagonism and anxiety.

***2. Duplication***

Acquisitions may lead to employees duplicating each other's duties. When two similar businesses combine, there may be cases where two departments or people do the same activity. This can cause excessive costs on wages. These transactions will therefore often lead to reorganization and job cuts to maximize efficiencies in human resources and other processes. This can reduce employee morale and lead to low productivity.

***3. Conflicting objectives***

The two companies involved in the acquisition may have distinct objectives since they have been operating individually until the transaciton. For instance, the original company may want to expand into new markets, but the acquired company may be looking to cut costs. This can bring resistance within the acquisition that can undermine efforts being made.

***4. Poorly matched businesses***

A business that doesn't look for expert advice when trying to identify the most suitable company to acquire may end up targeting a company that brings more challenges to the equation than benefits. This can deny an otherwise productive company the chance to grow.

***5. Pressure on suppliers***

Following an acquisition, the capacity of the suppliers of the company may not be enough to provide the additional services, supplies, or materials that will be needed. This may cripple the operations of the acquisition.

***6. Brand damage***

M&A may hurt the image of the new company or damage the existing brand. An evaluation on whether the two different brands should be kept separate must be done before the deal is made.

Merger vs. Acquisition – Comparative Table

| **Basis for comparison** | **Merger** | **Acquisition** |
|---|---|---|
| **Definition** | The merger is a process in which more than one companies come forward to work as one. | The acquisition is a process in which one company takes control of another company. |
| **Terms** | Considered to be friendly and planned. | Considered to be hostile and sometimes involuntary (not always) |
| **Title** | A new name is given. | The acquired company comes under the name of the acquiring company. |

| | | |
|---|---|---|
| **Scenario** | Two or more companies that consider each other on equal terms usually merge. | Acquiring a company is always larger than the acquired company. |
| **Power** | The power-difference is almost nil between the two companies. | The acquiring company gets to dictate terms. |
| **Stocks** | Merger leads to new stocks being issued. | In an acquisition, there are no new stocks issued. |
| **Example** | Merging of Glaxo Wellcome and SmithKline Beecham to GlaxoSmithKline | Tata Motors acquisition of Jaguar Land Rover |

**CONCLUSION**

A **merger** involves the mutual decision of two companies to combine and become one entity; it can be seen as a decision made by two "equals." A **takeover**, or **acquisition**, **is** usually the purchase of a smaller company by a larger one

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SCHOOL OF MANAGEMENT STUDIES

# UNIT V - BUSINESS ORGANISATION – SBAA 1104

**Business Finance**

The term **Business Finance** refers to the amount of money invested in a business. Finance is essential for every business and it is needed to purchase assets, raw materials, to keep the business and to handle all the financial activities related to the business.

**Financial need of Business**

One of the biggest challenges of starting a new business is making sure you'll have enough money to see you through the challenging first months.

Without adequate financial resources, your business will have a hard time finding its footing. Entrepreneurs also need to be realistic about how long it will take for revenues to catch up to costs. You may have to endure losses for one or two years—perhaps even longer—and you will need money to tide you over.

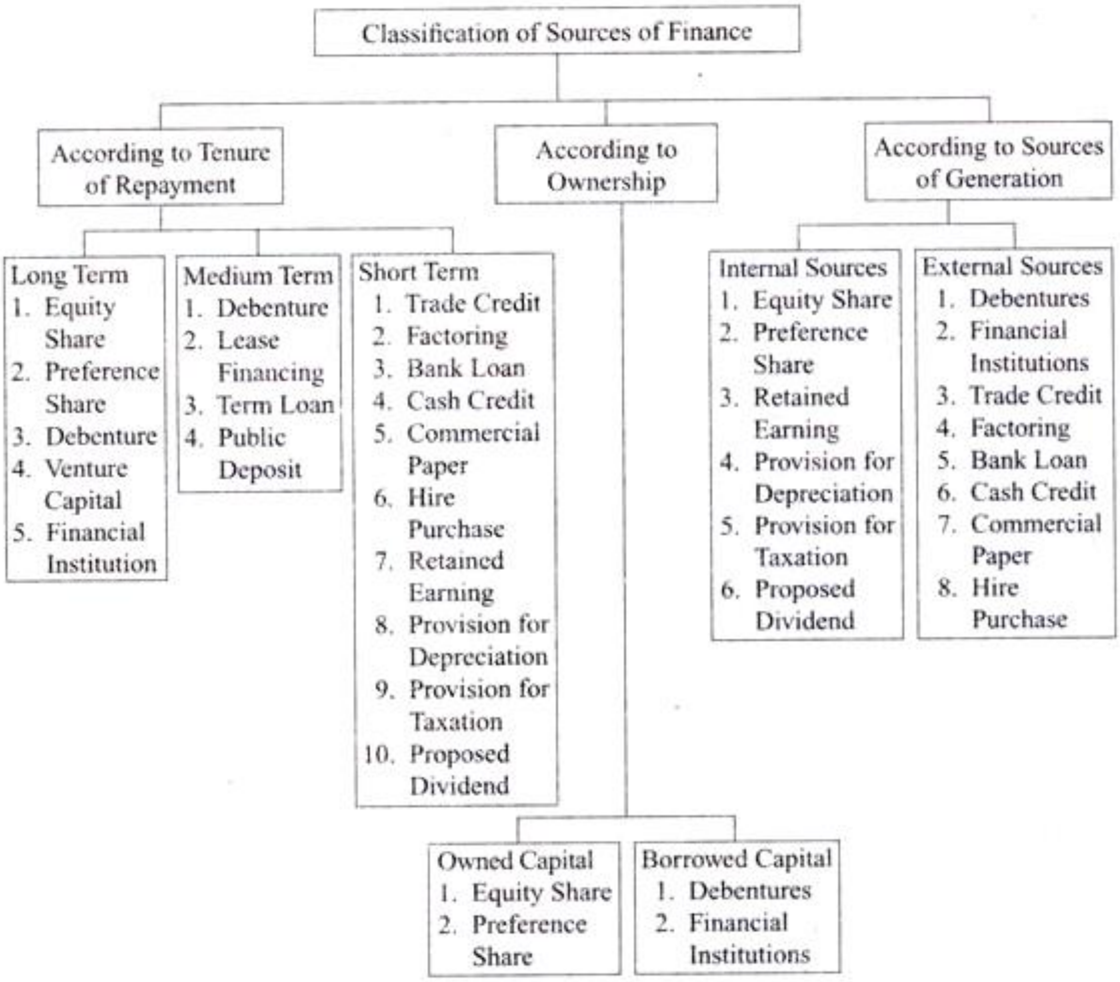
To ensure you have adequate funds, it's important to estimate your financial needs before starting a new business. The first step is to figure out your expenses. These can be divided into one-time start-up costs and recurring expenses.

## Sources of finance

**Finance** is significant for business because it cannot carry out its operations even for a single day without finance. It is therefore important to search the sources from where funds can be collected. The selection of source depends upon the amount of funds required, nature of business, repayment period, debt-equity mix, etc. The selection of source also depends upon the purposes for which funds are needed.

Funds required for acquiring machine, land & building, etc., should be procured from such sources, the tenure of which must be between 5 and 10 years. Funds required for more than 1 year but less than 5 years should be financed from medium-term sources. Funds required for meeting day-to-day expenses should be acquired from short-term sources.

**A firm can obtain funds from a variety of sources which may be classified as follows:**




**1. Long-term Sources:** A firm needs funds to purchase fixed assets such as land, plant & machinery, furniture, etc. These assets should be purchased from those funds which have a longer maturity repayment period. The capital required for purchasing these assets is known as fixed capital. So funds required for fixed capital must be financed using long-term sources of finance.

**2. Medium-term Sources:** Funds required for say, a heavy advertisement campaign, the benefit of which lasts for more than one accounting period, should be financed through medium-term sources of finance. In other words expenditure that results in deferred revenue should be financed through medium-term sources.

**3. Short-term Sources:** Funds required for meeting day-to-day expenses, i.e. revenue expenditure or working capital should be financed from short-term sources whose maturity period is one year or less.

**4. Owned Capital:** Owned capital represents equity capital, retained earnings and preference capital. Equity share has a perpetual life and are entitled to the residual income of the firm but the equity shareholders have the right to control the affairs of the business because they enjoy the voting rights.

**5. Borrowed Capital:** Borrowed capital represents debentures, term loans, public deposits, borrowings from bank, etc. These are contractual in nature. They are entitled to get a fixed rate of interest irrespective of profit and are to be repaid on a fixed date.

**6. Internal Sources:** If the funds are created internally, i.e. without using debt, such sources can be termed as internal sources. Examples of such could be: Ploughing back of profits, provision for depreciation, etc.

**7. External Sources:** If funds are re-used through the sources which create some obligation to the firm, such sources can be termed as external sources, e.g. lease financing, hire purchase, etc..

**Marketable Securities: Concept, Types**

**Marketable Securities** are the financial instruments that one can easily buy or sell in the market. The maturities of these financial instruments are usually less than a year. Since they have high liquidity, these investments are good for businesses that need quick cash. Some examples of these financial instruments are government bonds, common stock or certificates of deposit.

Businesses keep their cash in reserves. Such reserves help them in situations when they require cash, like for acquisitions or any unforeseen payment. However, companies do not put all their cash in the reserves. Instead, they invest some in short-term liquid securities to earn interest. This way, the cash not only earns an interest income, but a company can also easily liquidate the investment to meet any future cash need.

The returns on such securities are relatively lower due to their liquidity and the fact that we see them as safe investments. Apple holds a major portion of its wealth in the form of such

**TYPES**

Marketable securities broadly have two groups – Marketable debt securities and Marketable equity securities.

**Marketable debt securities** are government bonds and corporate bonds. One can trade these on the public exchange and their market price is also readily available. In the balance sheet, all marketable debt securities are shown as current at the cost, until a company realizes a gain or loss on the sale of the debt instrument.

**Marketable equity securities** are common stock and most preferred stock as well. One can also easily trade them on the public exchanges and their market price information is easily available. All marketable equity securities are shown in the balance sheet .

There is also a third type of marketable securities classified further into three categories –

i)Money market instruments,

ii) Derivatives,

iii)Indirect investments/Mutual Funds

Money market securities are short-term bonds, like Treasury bills (T-bills), banker's acceptances and commercial paper. Big financial entities purchase these in massive quantities.

**Money Market: instruments**

**Types of Instruments Traded in the Money Market**

Several financial instruments are created for short-term lending and borrowing in the money market, they include:

**1. Treasury Bills**

Treasury bills, also known as T-bills, are short term money market instruments. The RBI on behalf of the government to curb liquidity shortfalls. It is a promissory note with a guarantee of payment at a later date. The funds collected are usually used for short term requirements of the government. It is also used to reduce the overall fiscal deficit of the country.

Treasury bills or T-bills have zero-coupon rates, i.e. no interest is earned on them. Individuals can purchase T-bills at a discount to the face/value. Later, they are redeemed at a nominal value, thereby allowing the investors to earn the difference. For example, an individual purchase a 91-day T-bill which has a face value of Rs.100, which is discounted at Rs.95. At the time of maturity, the T-bill holder gets Rs.100, thus resulting in a profit of Rs.5 for the individual.

Therefore, it is an essential monetary instrument that the Reserve Bank of India uses. It helps RBI to regulate the total money supply in the economy as well as raising funds.

**2. Certificate of Deposit**

- The Certificate of Deposit (CD) is an agreement between the depositor and the bank where a predetermined amount of money is fixed for a specific time period
- Issued by the Federal Deposit Insurance Corporation (FDIC) and regulated by the Reserve Bank of India, the CD is a promissory note, the interest on which is paid by the bank
- The Certificate of Deposit is issued in dematerialised form i.e. issued electronically and may automatically be renewed if the depositor fails to decide what to do with the matured amount during the grace period of 7 days
- It also restricts the holder from withdrawing the amount on demand or paying a penalty, otherwise. When the Certificate of Deposit matures, the principal amount along with the interest earned is available for withdrawal

**3. Commercial Paper**

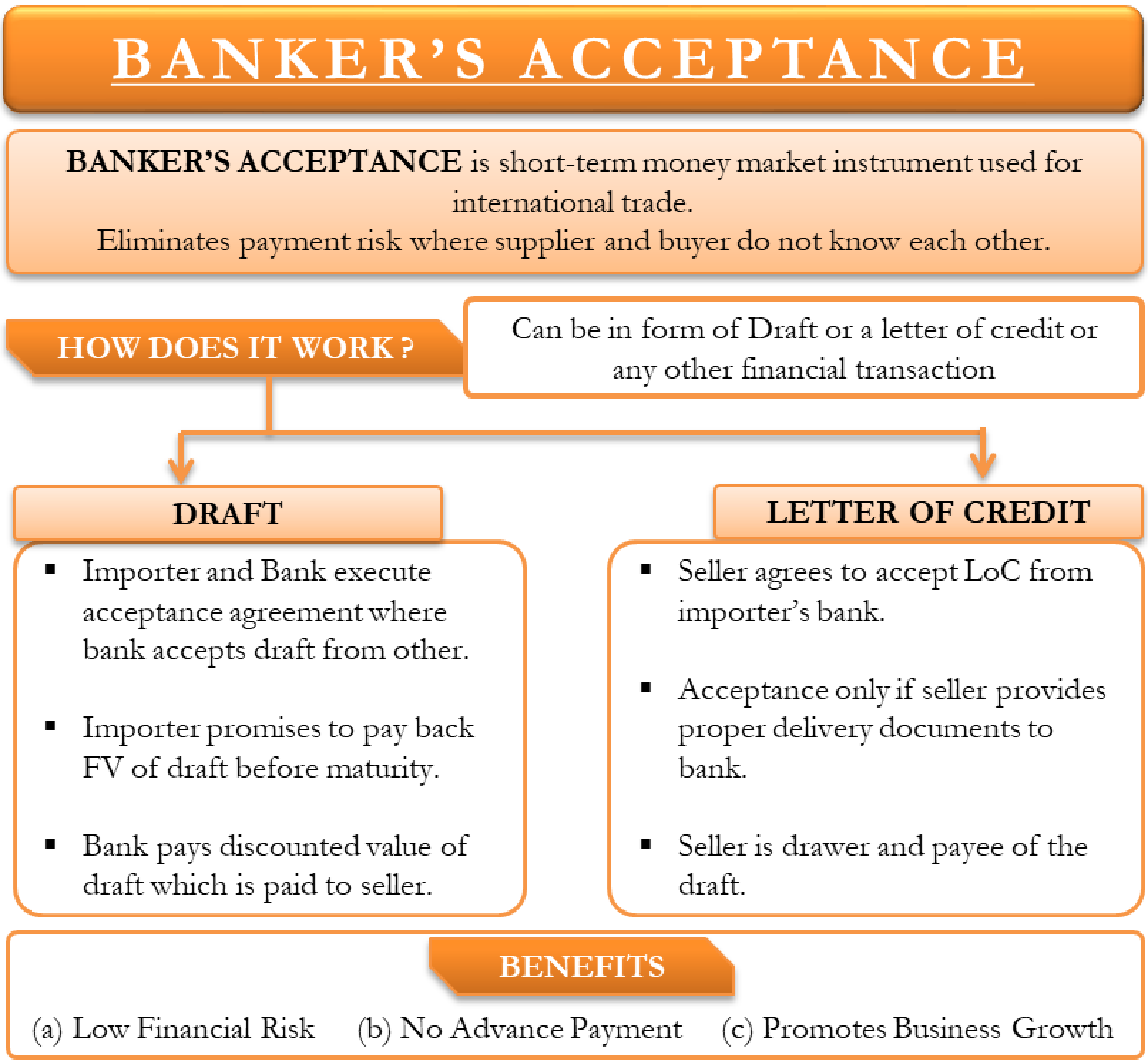
Commercial paper, also called CP, is a short-term debt instrument issued by companies to raise funds generally for a time period up to one year. It is an unsecured money market instrument issued in the form of a promissory note and was introduced in India for the first time in 1990.

Companies that enjoy high ratings from rating agencies often use CPs to diversify their sources of short-term borrowings. This gives investors an additional instrument. They are typically issued by large banks or corporations to cover short-term receivables and meet short-term financial obligations, such as funding for a new project.

CPs have a minimum maturity of seven days and a maximum of up to one year from the date of issue. However, the maturity date of the instrument should typically not go beyond the date up to which the credit rating of the issuer is valid. They can be issued in denominations of Rs 5 lakh or multiples thereof.

**4. Banker's Acceptance**

A banker's acceptance is a short-term debt instrument issued by a non-financial institution but guaranteed by a commercial bank. It is created by a drawer, providing the bearer the right to the money indicated on its face at a specified date. It is often used in international trade because of the benefits to both the drawer and bearer. The holder of the acceptance may decide to sell it on a secondary market, and investors can profit from the short-term investment. The date of maturity ranges between one month and six months from the date of issue.



**5. Repurchase Agreements**

- Repurchase agreements, or repos, are a form of short-term borrowing used in the money markets, involving the purchase of securities with the agreement to sell them back at a specific date, usually for a higher price.
- Repurchase agreements or repos and reverse repros represent the same transaction, but are titled differently depending on which side of the transaction you're on. For the party originally selling the security (and agreeing to repurchase it in the future) it is a repurchase agreement (RP). For the party originally buying the security (and agreeing to sell in the future) it is a reverse repurchase agreement (RRP) or reverse repo.
- Although it is considered a loan, the repurchase agreement involves the sale of an asset that is held as collateral until it the seller repurchases it at a premium.

**ii) Derivatives** A derivative is a contract between two or more parties whose value is based on an agreed-upon underlying financial asset (like a security) or set of assets (like an index). Common underlying instruments include bonds, commodities, currencies, interest rates, market indexes, and stocks.

In the investment industry, a 'Derivative' is a contract whose price is decided on the basis of one or more underlying assets. The underlying asset can be a currency, stock, commodity or a security (that bears interest). Sometimes, Derivatives are also used for trading in specific sectors such as foreign exchange, equity, treasury bills, etc.

**iii) Indirect investments/Mutual Fund**

Mutual funds pool money from the investing public and use that money to buy other securities, usually stocks and bonds. The value of the mutual fund company depends on the performance of the securities it decides to buy. So, when you buy a unit of a mutual fund, you are buying the performance of its portfolio or, more precisely, a part of the portfolio's value. Investing in a unit of a mutual fund is different from investing in shares of company. Unlike shares, mutual fund units do not give its holders any voting rights. A unit of a mutual fund represents investments in many different stocks (or other securities) instead of just one holding.

That's why the price of a mutual fund unit is referred to as the net asset value (NAV) per unit, sometimes expressed as NAVPS. A fund's NAV is derived by dividing the total value of the securities in the portfolio by the total amount of units outstanding.

**Types of mutual funds that are available in India:**

1. Open Ended Mutual Funds
    1. Debt/Income Funds
    2. Money Market/Liquid Funds
    3. Equity Funds
        1. Index Funds
        2. Sectoral Funds
        3. Tax Saving Mutual Funds
2. Close Ended Mutual Funds
    1. Capital Protection Funds
    2. Fixed Maturity Plans
3. Interval Funds

# 1. Open-Ended Mutual Funds

You may buy and sell units at any point while investing in open-ended mutual funds. There is no lock-in period or fixed maturity date. Below are four sub-categories of such funds.

### i)Debt or Income Funds

Debt Funds are the least risky type of mutual fund investments, as the corpus is invested in government securities, debentures, and other debt-related instruments. This is a low risk-low return investment and is ideal if you are willing to assume low risks and earn regular income.

### ii)Money Market or Liquid Funds

Liquid Funds invest their pooled money in short-term financial instruments. These funds are ideal if you want to park your surplus money in mutual funds that earn better returns than FDs and savings accounts in the short term. This allows you to earn returns in the interim period while awaiting lucrative opportunities.

### iii)Equity / Growth Funds

Equities are the highest yielding type of mutual fund. The accumulated corpus is principally invested in equities, thus being a high risk-high return portfolio. This is the ideal investment if you want long-term capital appreciation. Equity funds are further classified as below.

**A. Index Scheme**
Index funds that invest in indices such as the Nifty or Sensex. These adopt a rather passive investment strategy that performs in tandem with the movements of the indices.

**B. Sectoral Scheme**
Sectoral Mutual Fund schemes invest in instruments of a particular sector such as pharmaceutical, infrastructure, information technology (IT), and others. Sector funds may also invest in companies with small, medium, or large market capitalization. The risk involved is closely tied to the sector risks.

**C. Tax Saving**
Also known as Equity Linked Savings Scheme (ELSS), this type of mutual fund has a three-year lock-in period and offers tax benefits. The fund corpus is invested in equity-related instruments and offer long-term capital appreciation. As per Section 80C of the Income Tax (IT) Act, the investments made in ELSS funds are exempt from income tax.

### iv)Balanced Fund

Balanced Fund is the perfect mix of equities and fixed income securities as per pre-determined percentage. They enable you to enjoy growth and earn an income at periodic intervals. These funds are suitable for the cautiously aggressive investors.

## 2. Closed Ended Funds

Close-Ended Mutual Funds- have a fixed maturity period. You may invest in these only during the launch or New Fund Offer (NFO) period. Here are two types of close-ended MF schemes:

**i) Capital Protection Funds**

Evidently, these funds focus on safeguarding your principal investments and thus invest primarily in high-rated fixed income securities. A marginal component of the corpus is invested in equity. Thus, these funds deliver reasonable returns on your investments.

**ii)Fixed Maturity Plans (FMPs)**

As the name suggests, these schemes have a fixed maturity period and the corpus is invested in debt instruments that mature with the fund maturity. Such plans earn a fixed interest or coupon. Since FMPs are passively managed, the expenses on these are lower when compared to actively managed schemes.

## 3. Interval Funds

This is a mix of open and closed-ended funds that allow you to invest at pre-defined intervals. These type of funds offer the benefits of both open-ended and close-ended types of funds.

Based on your risk appetite, the period you want to stay invested and the type of returns that you expect, you can choose from the different types of mutual funds. It is recommended you choose funds that deliver stability, growth, and income for maximum benefits. Get ready to start your investment journey with mutual fund investments.

# Stock Market

Stock market is a place where people buy/sell shares of publicly listed companies. It offers a platform to facilitate seamless exchange of shares. In simple terms, if A wants to sell shares of Reliance Industries, the stock market will help him to meet the seller who is willing to buy Reliance Industries. However, it is important to note that a person can trade in the stock market only through a registered intermediary known as a stock broker. The buying and selling of shares take place through electronic medium.

# Major Stock Exchanges in India

There are two main stock exchanges in India where majority of the trades take place - Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE).

# Bombay Stock Exchange (BSE)

BSE is Asia’s first as well as the oldest stock exchange in India. It was established in 1875 and is located in Mumbai. It has a total of ~5,295 companies listed out of which ~3,972 are available for trading as on August 21, 2017. BSE Sensex is the flagship index of BSE. It measures the performance of the 30 largest, most liquid and financially stable companies across key sectors.

# National Stock Exchange (NSE)

NSE is the leading stock exchange in India where one can buy/sell shares of publicly listed companies. It was established in the year 1992 and is located in Mumbai. NSE has a flagship index named as NIFTY50. The index comprises of the top 50 companies based on its trading volume and market capitalisation. This index is widely used by investors in India as well as globally as the barometer of the Indian capital markets.

# Different Market Participants

There are a lot of individuals and corporate houses who trade in a stock market. Anyone who buys/sells shares in a stock market is termed as a market participant. Some of the categories of market participants are as follows:

- **Domestic Retail Participants**-These are individuals who transact in the markets.
- **NRI's and Overseas Citizen of India (OCI)**-These are people of Indian origin who reside outside India.
- **Domestic Institutions**-These are large corporate entities based in India (for example: LIC of India).
- **Domestic Asset Management Companies (AMC)**-The market participants in this category would be mutual fund companies like HDFC AMC, SBI Mutual Fund, DSP Black Rock and many more similar entities.
- **Foreign Institutional Investors**-FIIs are Non-Indian corporate entities such as foreign asset management companies, hedge funds and other investors.

**Functions of the Stock Exchange**

**Liquidity and Marketability:** One of the main drawing factors of the stock exchange is that it enables high liquidity. The securities can be sold at a moments notice and be converted to cash. It is a continuous market and the investors can divest and reinvest with ease as per their wishes.

**Price Determination:** In a secondary market, the only way to determine the price of securities in via the rules of supply and demand. A stock exchange enables this process via constant valuation of all the securities. Such prices of shares of various companies can be tracked via the index we call the Sensex.

**Safety:** The government strictlt governs and regulates the stock exchanges. In case of the BSE, the Securities Board of India is the governing body. All the transactions occur within the legal framework. This provides the investor with assurances and a safe place to transact in securities.

**Contribution to the Economy:** As we know the stock exchange deals in already issued securities. But these securities are continuously sold and resold and so on. This allows the funds to be mobilized and channelized instead of sitting idle. This boosts the economy.

**Spreading of Equity:** The stock exchange ensures wider ownership of securities. It actually educates the public about the safety and the benefits of investing in the stock market. It ensures a better quality of transactions and smooth functioning. The idea is to get more public investors and spread the ownership of securities for the benefit of everyone.

**Speculation:** One often hears that the stock exchange is a speculative market. And while this is true, the speculation is kept within the legal framework. For the stake of liquidity and price determination, a healthy dose of speculative trading is necessary, and the stock exchange provides us with such a platform.

**Role of SEBI and working of stock Exchanges**

**The Securities and Exchange Board of India (SEBI)** is the regulator for the securities market in India. It was established in 1988 and given statutory powers on 30 January 1992 through the SEBI Act, 1992.

Initially SEBI was a non statutory body without any statutory power. However, in 1992, the SEBI was given additional statutory power by the Government of India through an amendment to the Securities and Exchange Board of India Act, 1992.

Its main objective was to promote orderly and healthy growth of securities and to provide protection to the investors.

**Role of SEBI**

The main objective is to create such an environment which facilitates efficient mobilization and allocation of resources through the securities market. This environment consists of rules and regulations, policy framework, practices and infrastructures to meet the needs of three groups which mainly constitute the market i.e. issuers of securities (companies), the investors and the market intermediaries

In order to achieve its objectives, SEBI takes care of the three most important financial market participants.

**(i) To the Issuers**

These are the companies listed in the stock exchange which raise funds through the issue of shares. SEBI ensures that the issue of IPOs and FPOs can take place in a transparent and healthy way.

**(ii) To the Investors and Traders**

The capital markets are functioning only because the traders exist. SEBI is responsible for ensuring that the investors don’t become victims of any stock market manipulation or fraud.

**(iii) To the Intermediaries**

They act as mediators in the securities market and ensure that the stock market transactions take place in a smooth and secure manner. SEBI monitors the activities of the stock market intermediaries like brokers and sub-brokers.

# The functions of SEBI

The SEBI carries out the following three key functions to perform its roles.

**1. Protective Functions:** SEBI performs these functions for protecting the interests of the investors and financial institutions. Protective functions include checking price rigging, prevention of insider trading, promoting fair practices, creating awareness among investors and prohibition of fraudulent and unfair trade practices.

**2. Regulatory Functions:** Through regulatory functions, SEBI monitors the functioning of the financial market intermediaries. It designs the guidelines and code of conduct for financial intermediaries and regulates mergers, amalgamations, and takeovers takeover of companies.

SEBI also conducts inquiries and audit of stock exchanges. It acts as a registrar for the brokers, sub-brokers, merchant bankers and many others. SEBI has the power to levy fees on the capital market participants. Apart from controlling the intermediaries, SEBI also regulates the credit rating agencies.

**3. Development Functions:** Among the list of SEBI's development functions, one of them is imparting training to intermediaries. SEBI promotes fair trading and malpractices reduction. It also educates and makes investors aware of the stock market by utilizing the funds available in Investor Education and Protection Fund **(**IEPF).

**Conclusion**

The stock market is one of the most crucial indicators of a country's economic health. If people lose faith in the market, the number of participants will go down. Furthermore, the country will also start losing FDIs and FIIs considerably which will substantially hamper the country's foreign exchange inflows.

Before SEBI was established many scams and malpractices took place in the Indian stock market. One of the famous Indian stock market scams was "Harshad Mehta scam."

After SEBI came into power, stock market affairs started becoming healthier and more transparent. Nonetheless, some securities mark scams have taken place even after SEBI came into power. One famous such scam was "Ketan Parekh scam"

Although unfair activities do happen in the Indian capital market even as of today, their frequency is quite less. Moreover, the security market statutes and regulations are updated time and again. Therefore, day by day, SEBI is getting more and more stringent with its authority.