STUDY MATERIAL

FOUNDATION PROGRAMME

BUSINESS ENVIRONMENT AND ENTREPRENEURSHIP

PAPER 1

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

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FOUNDATION PROGRAMME – IMPORTANT NOTE

The study material has been written in lucid and simple language and conscious efforts have been made to explain business environment, different forms and functions of organizations, basic elements of business and mercantile laws and concept of entrepreneurship. This study material has been divided into three main parts–

Part-A	Business Environment,
Part-B	Business Laws, and
Part-C	Entrepreneurship

There is computer based examination for the Foundatian Programme. Where Student are required to answer multiple choice questions.

For supplementing the information contained in the study material, students may refer to the economic and financial dailies, commercial, legal and management journals, Economic Survey (latest), CS Foundation Course e-Bulletin, Suggested Readings and References mentioned in the study material and relevant websites.

The objective of the study material is to provide students with the learning material according to the syllabus of the subject of the Foundation Programme. In the event of any doubt, students may write to the Directorate of Academics in the Institute for clarification at **academics@icsi.edu**

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Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same are brought to its notice for issue of corrigendum in the e-Bulletin CS Foundation Course.

SYLLABUS

PAPER 1: BUSINESS ENVIRONMENT AND ENTREPRENEURSHIP

Level of Knowledge: Basic Knowledge

Objective: *To give orientation about different forms of organizations, functions in organizations, business strategies and environment, along with an exposure to elements of business laws and entrepreneurship.*

PART A: BUSINESS ENVIRONMENT (30 MARKS)

1. **Business Environment**
   - Introduction and Features
   - Concepts of Vision & Mission Statements
   - Types of Environment:
     - Internal to the Enterprise
       - Value System, Management Structure and Nature, Human Resource, Company Image and Brand Value, Physical Assets, Facilities, Research & Development, Intangibles, Competitive Advantage
       - External to the Enterprise
       - Micro: Suppliers, Customers, Market Intermediaries
       - Macro: Demography, Natural, Legal & Political, Technological, Economy, Competition, Socio-cultural and International
   - Business Environment with reference to Global Integration
2. **Forms of Business Organization**

   Concept and Features in relation to following business models:
   - Sole Proprietorship
   - Partnership
   - Company
   - Statutory Bodies and Corporations
   - HUF and Family Business
   - Cooperatives, Societies and Trusts
   - Limited Liability Partnership
   - Other Forms of Organizations
3. **Scales of Business**
   - Micro, Small And Medium Enterprises
   - Large Scale Enterprises and Public Enterprises
   - MNCs

4. **Emerging Trends in Business**

   Concepts, Advantages and Limitations:

   – Network Marketing

   – Franchising

   – Business Process Outsourcing (BPO)

   – E-Commerce

   – M-Commerce

5. **Business Functions**

   – Strategic: Planning, Budgetary Control, R&D, Location of a Business, Factors affecting Location, Decision Making and Government Policy

   – Supply Chain: Objectives, Importance, Limitations, Steps, Various Production Processes

   – Finance: Nature, Scope, Significance of Financial Management, Financial Planning (Management Decisions – Sources of Funds, Investments of Funds, Distribution of Profits)

   – Marketing: Concept, Difference Between Marketing and Selling, Marketing Mix, Functions of Marketing

   – Human Resources: Nature, Objectives, Significance

   – Services: Legal, Secretarial, Accounting, Administration, Information and Communication Technology

PART B: BUSINESS LAWS (40 MARKS)

6. **Introduction to Law**

   – Meaning of Law and its Significance; Relevance of Law to Modern Civilized Society; Sources of Law; Legal Terminology and Maxims; Understanding Citation of Cases

7. **Elements of Company Law**

   – Meaning and Nature of Company; Promotion and Incorporation of a Company; Familiarization with the Concept of Board of Directors, Shareholders and Company Meetings; Company Secretary; E-Governance

8. **Elements of Law relating to Partnership**

   – Nature of Partnership and Similar Organizations - Co-Ownership, HUF; Partnership Deed; Rights and Liabilities of Partners: New Admitted, Retiring and Deceased Partners; Implied Authority of Partners and its Scope; Registration of Firms; Dissolution of Firms and of the Partnership

9. **Elements of Law relating to Contract**

   – Contract - Meaning; Essentials of a Valid Contract; Nature and Performance of Contract; Termination and Discharge of Contract; Indemnity and Guarantee; Bailment and Pledge; Law of Agency

10. **Elements of Law relating to Sale of Goods**

    – Essentials of a Contract of Sale; Sale Distinguished from Agreement to Sell, Bailment, Contract for Work and Labour and Hire-Purchase; Conditions and Warranties; Transfer of Title by Non-Owners; Doctrine of Caveat Emptor; Performance of the Contract of Sale; Rights of Unpaid Seller

11. **Elements of Law relating to Negotiable Instruments**

    – Definition of a Negotiable Instrument; Instruments Negotiable by Law and by Custom; Types of

Negotiable Instruments; Parties to a Negotiable Instrument - Duties, Rights, Liabilities and Discharge; Material Alteration; Crossing of Cheques; Payment and Collection of Cheques and Demand Drafts; Presumption of Law as to Negotiable Instruments

PART C: ENTREPRENEURSHIP (30 MARKS)

12. Entrepreneurship

- **Introduction to Concept of Entrepreneurship, Traits of Entrepreneur, Entrepreneurship:** Who is an Entrepreneur, Why Entrepreneurship
- **Types of Entrepreneurs:** Idealist, Optimizer, Hard Worker, Sustainer, Improver, Advisor, Superstar, Artiste, Visionary, Analyst, Fireball, Juggler, Hero, Healer.
- Distinction Between Entrepreneur and Manager
- **Entrepreneurship and Intrapreneurship:** Definition, Features, Examples and Difference

13. Entrepreneurship – Creativity and Innovation

- **Entrepreneurial Venture Initiation:** Sensing Entrepreneurial Opportunities, Environment Scanning, Market Assessment
- **Assessment of Business Opportunities:** Identification of Entrepreneurial Opportunities, Selection of an Enterprise, Steps in setting up of an Enterprise
- **Entrepreneurial Motivation:** Meaning and Concept, Process of Achievement Motivation, Self-efficacy, Creativity, Risk Taking, Leadership, Communication and Influencing Ability, Mentoring and Planning Action
- Developing Effective Business Plan

14. Growth & Challenges of Entrepreneurial Venture

- **Strategic Planning for Emerging Venture:** Entrepreneurial Opportunities in Contemporary Business Environment
- **Financing the Entrepreneurial Business:** Resource Assessment -Financial and Non – Financial, Fixed and Working Capital Requirement, Funds Flow, Sources and Means of Finance.
- **Managing the Growing Business:** Effecting Change, Modernization, Expansion, and Diversification.

LIST OF RECOMMENDED BOOKS*

PAPER 1 : BUSINESS ENVIRONMENT AND ENTREPRENEURSHIP

READINGS

1.	M.C. Shukla	A Manual of Mercantile Laws; Sultan Chand & Company, New Delhi.
2.	N.D. Kapoor	Mercantile Law; Sultan Chand & Co., New Delhi.
3.	N.D. Kapoor & Dinkar Pagare	Business Laws and Management; Sultan Chand & Sons.
4.	M.C. Kuchhal	Mercantile Law; Vikas Publishing House, New Delhi.
5.	P. P. S. Gogna	A Textbook of Business Law; Sultan Chand & Company, New Delhi.
6.	Poonam Gandhi	Business Studies; Dhanpat Rai & Company Private Limited, Delhi.
7.	NCERT	Business Studies Text Book for Class 10+2
8.	D. Chandra Bose	Business Laws; PHI Learning Pvt. Ltd.

REFERENCES

1.	Sen & Mitra	Commercial Law; The World Press Pvt. Ltd., Calcutta.
2.	Ian Wirthington & Chris Britton	The Business Environment; Pearson Education Ltd., England.
3.	Raymond W.Y. Kao	Entrepreneurship and Enterprises Development

*This study material is sufficient from the point of view of syllabus. The students may refer these books for further knowledge and study of the subject.

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PART A
BUSINESS ENVIRONMENT

LESSONS

The term business is understood and explained in different ways by different people. For some, business is an activity, for some it is a method of transacting, for others; it is a method of making money. People also argue that business is an organized activity to achieve certain pre-determined goals or objectives. The concept of business has undergone a vast change. From a producer driven activity, it has become consumer centered phenomenon. While, earlier concept was 'to sell what is being produced', the modern concept has become 'to produce what is being desired'.

The term business environment refers to the aggregate of all forces, factors and institutions which are internally affecting the business through management structure and policies as well as which are external to and beyond the control of individual business enterprises; but which influence their functioning. Business involves activities, which links an organization with outside world. Within an organization, a business is governed by the behaviour of its employees, management or decision makers. In other words, business environment may be defined as all those conditions and forces external to a business under which it operates.

It is in this backdrop, it becomes essential to acquaint students with nature, complexity and interrelation among business environmental forces that may act upon a variety of types of business organizations and hence, influence business performances.

Lesson 1
Business Environment

LESSON OUTLINE

- Introduction
- Meaning of Business Environment
- Features of Business Environment
- Importance Of Business Environment
- Vision and Mission Statement
- Types of Business Environment
  - Internal Environment
  - External Environment
    - Micro Environment
    - Macro Environment
- Review Questions
- Global Integration and Business Environment
- Privatisation
- Liberalisation
- Globalisation
- Lesson Round Up
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- Self Test Questions

LEARNING OBJECTIVES

In modern circumstances, the business operates in a turbulent environment. Internal and external factors affect the business. Internal factors include the vision and mission of the organization and other internal mechanism of the organization. On the other hand, external factors are the ones which lie beyond the control of business and impact the organizations immensely in operations.

External environment relates with the outsiders such as the suppliers, customers, creditors, employees, Government, etc. For a business organization to achive success, it is important to go hand in hand, both with internal as well as external factors.

Thus, it is necessary to study the environment in which the business operates. By knowing the environment impact over a business, the entrepreneur may make decisions in a way which are at par for smooth running of the business.

Since, the progress of the organisation depends upon all factors and the enterprises are required to deal with them in nascent manner, this lesson will provide basic insight into such business environment.

The nature of the global business environment guarantees that no matter how hard we work to create a stable and healthy organisation, our organisation will continue to experience dramatic changes far beyond our control.

Margaret J Wheatley

INTRODUCTION

According to Barnard "Environment consists of atoms and molecules, agglomeration of things in motion, alive, of men and emotions, of physical and social law, social ideas, norms of actions, of forces and resistance. The number is infinite and they are always present, they are always changing". Any business works within the framework provided by the various elements of society. Environment includes all the conditions and circumstances, influences surrounding and affects the total organization or any of its part. Business is all around us. It has a role to play in every aspect of our lives. Every activity of human being involves business to satisfy his unlimited wants and desires. Despite being universal and primary feature of human existence, it is not possible to define business with precision.

MEANING OF BUSINESS ENVIRONMENT

Business may be understood as the organized efforts of an enterprise to supply consumers with goods and services for a profit. Businesses vary in size, as measured by the number of employees or by sales volume etc. But, all businesses share one common purpose that is to earn profits.

The purposes of business that goes beyond earning profits are:

- an important institution in society
- for the supply of goods and services
- creating job opportunities
- offering better quality of life
- contributing to the economic growth of the country.

Hence, it is understood that the role of business is crucial from the point of view of individuals and national society as well. Society cannot do without business. Similarly, it requires no emphasis that business needs society as much. Modern business is dynamic. If there is any single word that can best describe today's business, it is 'change'. It is 'change' that makes the companies spend substantially on Research and development (R&D) to survive in the market. Environment refers to all forces, which have a bearing on the functioning of business. They can be forces of economic, social, political and technological factors, apart from internal forces of the organisation.

Environment factors are largely if not totally, external and beyond the control of individual industrial enterprises and their managements. The business environment poses threats to a firm or offers immense opportunities for potential market exploitation.

The success of every business depends on adapting itself to the environment within which it functions. For example, when there is a change in the government polices, the business has to make the necessary changes to adapt it to the new policies. Similarly, a change in the technology may render the existing products obsolete, as we have seen that the introduction of computer has replaced the typewriters; the color television has made the black and white television out of fashion. Again a change in the fashion or customers' taste may shift the demand in the market for a particular product, e.g., the demand for jeans reduced the sale of other traditional wear. All these aspects are external factors that are beyond the control of the business. So the business units must have to adapt themselves to these changes in order to survive and succeed in business.

Hence, it is very necessary to have a clear understanding of the concept of business environment and the nature of its various components.

FEATURES OF BUSINESS ENVIRONMENT

Understanding environment within which the business is to operate is very important for successful business. Some of the features of business environment are as follows:

(i) *Totality of External Forces:* Business environment is the sum total of all things external to business firms and, as such, is aggregative in nature.

(ii) *Specific and General Forces:* Business environment includes both specific and general forces. Specific forces (such as investors, customers, competitors and suppliers) affect individual enterprises directly and immediately in their day-to-day working. General forces (such as social, political, legal and technological conditions) have impact on all business enterprises and thus may affect an individual firm indirectly only.

(iii) *Dynamic Nature:* Business environment is dynamic in nature. It keeps on changing whether in terms of technological improvement, shifts in consumer preferences or entry of new competition in the market.

(iv) *Uncertainty:* Business environment is largely uncertain as it is very difficult to predict future happenings, especially when environment changes are taking place too frequently as in the case of information technology or fashion industries.

(v) *Relativity:* Business environment is a relative concept since it differs from country to country and even region to region. Political conditions in the USA, for instance, differ from those in China or Pakistan. Similarly, demand for sarees may be fairly high in India whereas it may be almost non-existent in France.

(vi) *Multi-faceted:* Business environment changes are frequent and depend on knowledge and existence of business person. Changes may be viewed differently bu different individuals. It may be an opportunity for some or a threat for others.

IMPORTANCE OF BUSINESS ENVIRONMENT

There is a close and continuous interaction between the business and its environment. This interaction helps in strengthening the business firm and using its resources more effectively. As stated above, the business environment is multifaceted, uncertain, and dynamic in nature which has a far-reaching impact on the survival and growth of the business. To be more specific, proper understanding of various aspects of business environment such as social, political, legal and economic helps the business in the following ways:

(i) *First Mover Advantage:* Early identification of opportunities helps an enterprise to be the first to exploit them instead of losing them to competitors. For example, Maruti Udyog became the leader in the small car market because it was the first to recognize the need of small cars in India.

(ii) *Identification of Threats:* Identification of possible threats helps in taking corrective and improving measures to survive the competition. For instance; if an Indian firm finds that a foreign multinational is entering the Indian market, it can meet the threat by adopting measures like, by improving the quality of the product, reducing cost of the production, engaging in aggressive advertising, and so on.

(iii) *Coping with Rapid Changes:* All types of enterprises are facing increasingly dynamic environment. In order to effectively cope with these significant changes, firms must understand and examine the environment and develop suitable course of action.

(iv) *Improving Performance:* The enterprises that continuously monitor their environment and adopt suitable business practices are the ones which not only improve their present performance but also continue to succeed in the market for a longer period.

(v) *Giving Direction for Growth:* The interaction with the environment leads to opening up new frontiers of growth for the business firms. It enables the business to identify the areas for growth and expansion of their activities.

(vi) *Meeting Competition:* It helps the firms to analyse the competitors' strategies and formulate their own strategies accordingly in order to cope with the rapidly increasing competition.

(vii) *Image Building:* Environmental understanding helps the business organisations in improving their image by showing their sensitivity to the environment within which they are working. For example, in view of the shortage of power, many companies have set up Captive Power Plants (CPP) in their factories to meet their own requirement of power and saving to loss of energy in transmission.

(viii) *Continuous Learning:* Environmental analysis makes the task of managers easier in dealing with business challenges. The managers are motivated to continuously update their knowledge, understanding and skills to meet the predicted changes in realm of business.

VISION AND MISSION STATEMENT

The business vision and mission is paramount to the future growth and success of the business; no matter the size. The vision and mission not only guides the course of the business and its employees, it also is paramount in marketing your brand to your customers

A Vision Statement describes the desired future position of the company.

A Mission Statement defines the company's business, its objectives and its approach to reach those objectives.

Elements of Mission and Vision Statements are often combined to provide a statement of the purposes, goals and values of the company. However, sometimes the two terms are used interchangeably. Mission and Vision statements are commonly used to:

Internal to Organisation

– guide management's thinking on strategic issues, especially during times of significant change

– help define performance standards

– inspire employees to work more productively by providing focussed and common goals

– guide employee's decision making

– help establish a framework for ethical behavior.

External to Organisation

– enlist external support

– create closer linkages and better communication with customers, suppliers and alliance partners

– serves as a public relations tool.

Vision Statement

Your vision statement is where you want your business to reach at. It is your future dream for your business. It is your optimum version of your business or where you can visualize being positioned in 3, 5 or 7 years time. Or it can be timeless which is closer to impossible than possible. It should keep your business reaching for new heights.

Examples of Vision Statements:

– Disney "to make people happy".

– Sony "we invite new thinking, so even more fantastic ideas can evolve. We take chances. We exceed expectations. We help dreamers dream".

– ICSI "to be a global leader in promoting good corporate governance".

Mission Statement

Where your vision is your ultimate goal, your mission is how you will get there. Your mission explains why your business exists.

It can be crafted in the following steps:

– What does your company do?

– Who do you do it for?

– Where do you exist?

– How does it do it?

– Why does your company do it?

It may help to start with "our mission is to…." And then fill the rest.

Examples of Mission Statements:

– Nike "to bring inspiration and innovation to every athlete in the world".

– Face book "to give people the power to share and make the world more open and connected".

– Google "to organize the world's information and make it universally accessible and useful".

– ICSI "to develop high caliber professionals facilitating good corporate governance".

TYPES OF BUSINESS ENVIRONMENT

There are mainly two types of business environment, internal and external. A business has absolute control in the internal environment, whereas it has no control on the external environment. It is therefore, required by businesses, to modify their internal environment on the basis of pressures from external.

INTERNAL ENVIRONMENT

The internal environment has received considerable attention by firms. Internal environment contains the owner of the business, the shareholders, the managing director, the non-managers, employees, the customers, the infrastructure of the business organization, and the culture of the organization.

It includes 6 Ms i.e.

– Man (Human Resource)

– Money (Financial Factors)

– Marketing Resources

– Machinery (Physical Assets)

– Management Structure and Nature

– Miscellaneous Factors (Research and Development, Company Image and Brand Equity, Value System, Competitive Advantage)

Usually, these factors are within the control of business. Business can make changes in these factors according to the change in the functioning of enterprise.

Human Resource (MAN)

The human resource is the important factor for any organization as it contributes to the strength and weakness of any organization. The human resource in any organization must have characteristics like skills, quality, high morale, commitment towards the work, attitude, etc. The involvement and initiative of the people in an organization at different levels may vary from organization to organization. The organizational culture and over all environment have bearing on them. It is an internal factor and an organisation has absolute control on changing this factor as per the needs of the enterprise and other forces.

Financial Factors (MONEY)

Factors like financial policies, financial positions and capital structure are another important internal factor which has a substantial impact on business functioning and performance.

Financial facilities are required to start and operate the organisation. The sources of finance are share capital, banking and other financial institutions and unorganised capital markets. The recent changes in the Indian capital market indicate the availability of plenty of finance, both from the financial institutions as well as from the general public. The availability of finance coupled with various incentives attached is a facilitating internal factor.

Marketing Resources

Resources like the organization for marketing, quality of the marketing men, brand equity and distribution network have direct impact on marketing efficiency of the company and thereby, affecting the decision making component of the management. This, in lieu has great impact on the internal environment of business.

Physical Assets and Facilities

Facilities like production capacity, technology are among the factors which influences the competitiveness of the firm. The proper acquisition and working of the assets is indeed essential for efficient working of the organization. An organisation invests money in plant and machinery because it expects a positive rate of return over cost in future. The revenue from the use of plant and machinery should be sufficient so as to cover the invested money, operating costs, and generate enough profit to satisfy the organisation. The availability of plant and machinery is dependent on technological development of the country and the government's approach towards foreign technical collaboration.

Management Structure and Nature

The structure of the organization also influences the business decisions. Being internal forces, the organizational structure like the composition of board of directors influences the decisions of business. The structure and style of the organization directly has an impact on the decision making decisions of a firm. These needs to be appropriately managed for smooth functioning and operations. The strategies available to an organisation are determined by its structure. Different strategies are better suited to different environments. Thus, if an organisation has to thrive, its structure must fit its business environment in which it develops. Some markets and environments change faster than others. A firm working in high technological environment, for example, needs to have a fast reaction time because its competitors are introducing new products all the time. In rapidly changing environments, organizations may find it difficult to stay up to date on all the changes and implications of their own operations and activities. Organizations in slow markets tend to have rigid, hierarchical structures, while those in changing markets are more adaptive. They can create new divisions in their management structure, to deal with emerging issues.

Miscellaneous Factors

The other internal factors that contribute to the business environment are as follows:

(i) *Research and Development:* Though Research and Development needs are mostly outsourced from the external environment but it has a direct impact on working, operations and decision making of the organization. This aspect mainly determines the company's ability to innovate and compete. R&D mainly results in technological improvements of the Business environment. The technological environment refers to the sum total of knowledge providing ways of doing things. It may include inventions and techniques which affect the way of doing things that is, designing, producing and distributing products. A given technology affects an organisation, in the manner it is organised and faces competition.

(ii) *Company Image and Brand Equity:* The image of the company in the outside market has the impact on the internal environment of the company. It helps in raising the finance, making joint ventures, other alliances, expansions and acquisitions, entering sale and purchase contracts, launching new products, etc. Brand equity also helps the company in similar manner.

(iii) *Value System:* The principles of right and wrong that are accepted by an individual or organisation are what comprise value system. The value system of the founders and those at the helm of affairs has important bearing on the choice of business, the mission and the objectives of the organization, business policies and practices. These values helps guide the basic principles of business for a period of time which moulds an impression of positivism among people dealing with the business. The values are independent of business purposes and are integral part for success of business.

(iv) *Competitive Advantage:* Competitor analysis is a critical aspect of analyzing the internal business environment. Competitor's actions affect the ability of the business to make profits, because competitors will continually seek to gain an advantage over each other, by differentiating their product and service, and by seeking to provide better value for money. It involves:

- identifying the actual competitors
- assessing competitors' objectives, strategies, strengths & weaknesses, and reaction patterns
- selecting the strategies to deal with competitors.

The internal analysis of strengths and weaknesses focuses on internal factors that give an organization certain advantages and disadvantages in meeting the needs of its target market thereby gaining the competitive edge over the competitors.

EXTERNAL ENVIRONMENT

The external environment of an organisation comprises of all entities that exists outside its boundaries, but have significant influence over its growth and survival. An organisation has little or no control over its external environment but needs to constantly monitor and adapt to these external changes. A proactive or reactive response leads to significantly different outcomes.

There are two types of external environment

- Micro/Operating Environment
- Macro/General Environment

MICRO ENVIRONMENT

The micro environment is also known as the task environment and operating environment because the micro environmental forces, though are external factors, still have a direct bearing on the operations of the firm. The micro environment consists of the factors in the company's immediate environment that affects the performance and working of the company. The micro environmental factors are more intimately linked with the company than the macro factors. The micro forces need not necessarily affect all the firms in a particular industry in the similar ways. Some of the micro factors may be particular to any given type of organisation.

Micro environmental factors, internal factors close to a business that have a direct impact on its strategy includes:

- Customers
- Employees
- Suppliers
- Shareholders
- Media
- Competitors

(i) *Customers:* Organizations survive on the basis of meeting 'customer needs and wants' and providing benefits to their customers. Failure to do so will result in a failed business strategy. This includes offering customers the best quality products at reasonable prices.

(ii) *Employees:* Employing the correct staff and keeping staff motivated is an essential part of an organization's strategic planning process. Training and development play a critical role in achieving a competitive edge; especially in service sector marketing. Employees have a substantial influence on the success of the enterprise. They help in executing the policies and plans of business. If this factor is not given, as much attention as it requires, it may prove to be non beneficial for the organisation as employees after customer, are the backbone of the organisation.

(iii) *Suppliers:* Suppliers provide businesses with the materials they need to carry out their manufacturing and production activities. A supplier's behaviour will directly impact the business it supplies. For example, if a supplier provides a poor service, this could increase timescales or lower product quality. An increase in raw material prices will affect an organization's marketing mix strategy and may even force price increases. Close supplier relationships are an effective way to remain competitive and secure quality products.

(iv) *Shareholders:* A shareholder is an individual that invests into company's business. They own shares of the company thereby end up owning the company itself. Therefore, they have the right to vote on decisions that affect the operations of company. This means that shareholders affect the functions of the business. The introduction of public shareholders brings new pressures as public shareholders want a return from their money invested in the company. Shareholder pressure to increase profits will affect organizational strategy. Relationships with shareholders need to be managed carefully as rapid short term increases in profit could detrimentally affect the long term success of the business, if all is distributed as dividend. On the other hand, to keep shareholder's motivation, appropriate dividends are needed to be distributed. There has to be a balance between health of the organisation and interests of shareholders.

(v) *Media:* Positive media attention can 'make' an organisation (or its products) and negative media attention can 'break' an are required. Organizations need to mange the media so that it helps promote the positive things about the organisation and conversely reduce the impact of a negative event on their reputation. Some organizations will even employ public relations (PR) consultants or 'gurus' to help them manage a particular event or incident. Consumer television programmes with a wide and more direct audience can also have a very powerful impact on the success of an organisation. Some business recognizes this and uses media support for building their image and reputation.

(vi) *Competitors:* The name of the game in marketing a product is differentiation. Can the organisation offer benefits that *are* better than those offered by competitors? Does the business have a unique selling point (USP)? Competitor analysis and monitoring is crucial if an organisation is to maintain or improve its position within the market. If a business is unaware of its competitor's activities, they will find it very difficult to 'beat' them. The market can move very quickly, whether that is a change in trading conditions, consumer behaviour or technological developments. As a business, it is important to examine competitors' responses to the changes, so that firm can maximize the benefits.

MACRO ENVIRONMENT

Macro environment is also known as general environment and remote environment. Macro factors are generally more uncontrollable than micro environment factors. When the macro factors become uncontrollable, the success of company depends upon its adaptability to the environment. This environment has a bearing on the strategies adopted by the firms and any changes in the areas of the macro environment are likely to have a far-reaching impact on their operations.

The macro environment is primarily concerned with major issues and upcoming changes in the environment. The acronym for the macro analysis is "STEEP." The five areas of interest are:

– Socio-Cultural and Demographics

– Technology

– Economic Conditions

– Ecology and Physical Environment

– Political and Legal

(i) *Socio Cultural and Demographics:* Societal values and lifestyles change over time, and the most important of these; directly or indirectly leave an impact on the business environment. For example, over the past generation, it has become acceptable for women to work; people are not retiring at 65; and people are more aware of the environment etc.

The changes in culture and lifestyle may come from many sources: medical (smoking, healthy eating, exercises); science (global warming, going 'green'); economic (people working longer, women in the workforce); cultural diversity (music preferences, foods, living accommodations, medicine); and technologies (biodegradable plastic) are just a few examples.

These changes will be important to the industry and to the business. The social environment of business includes social factors like customs, traditions, values, beliefs, poverty, literacy, life expectancy rate etc. The social structure and the values that a society cherishes have a considerable influence on the functioning of business firms. For example, during festive seasons, there is an increase in the demand for new clothes, sweets, fruits, flower, etc. Due to increase in literacy rate, the consumers are becoming more conscious of the quality of the products. Due to change in family composition, more nuclear families with single child concepts have come up. This increases the demand for the different types of household goods. It may be noted that the consumption patterns, the dressing and living styles of people belonging to different social structures and culture vary significantly.

Demographics refer to the size, density, distribution and growth rate of population. All these factors have a bearing on the demand for various goods and services. For example, a country where population rate is high and children constitute a large section of population, and then, there will be more demand for such products. Similarly, the demand of the people of cities and towns are different than that of people of rural areas. The high rise of population indicates the easy availability of labour. These encourage the business enterprises to use labour intensive techniques of production. Moreover, availability of skilled labour in certain areas motivates the firms to set up their units in such area. For example, the business units from America, Canada, Australia, Germany, UK, are coming to India due to easy availability of skilled manpower. Thus, a firm that keeps a watch on the changes on the demographic front and reads them accurately will find opportunities knocking at its doorsteps.

(ii) *Technology:* Technology is understood as the systematic application of scientific or other organised knowledge to practical tasks. Technology changes fast and to keep the pace with the dynamics of business environment; organisation must be on its toes to adapt to the changed technology in their system. The business in a country is greatly influenced by the technological development. The technology adopted by the industries determines the type and quality of goods and services produced. Technological environment influences the business in terms of investment in technology, consistent application of technology and the effects of technology on markets. Technological environment include the methods, techniques and approaches adopted for production of goods and services and its distribution. The varying technological environments affect the designing of products in different countries. Technology encompasses something more than computers. Technology comes in many forms such as medical devices, new plastics, and production techniques.

(iii) *Economic Conditions:* There is a close relationship between business and its economic environment. It obtains all inputs from economic environment and all its output is absorbed here with. The state of the economy is usually in flux. The current situation (specific to the industry) and any changes that may be forecast are important. The economy goes through a series of fluctuations associated with general booms and recessions in economic activity. In a boom nearly all business are benefited whereas recession is a case vice versa. Business is influenced by economic aspects like interest rates, wage rates etc. The survival and success of each and every business enterprise depends fully on its economic environment. The main factors that affect the economic environment are:

– **Economic Conditions:** The economic conditions of a country refer to a set of economic factors that have great influence on business organizations and their operations. These include gross domestic product, per capita income, markets for goods and services, availability of capital, foreign exchange reserve, growth of foreign trade, strength of capital market etc. All these help in improving the pace of economic growth.

– **Economic Policies:** All business activities and operations are directly influenced by the economic policies framed by the government from time to time. Some of the important economic policies are:

- Industrial Policy
- Fiscal Policy Monetary Policy
- Foreign Investment Policy
- Export –Import Policy (EXIM Policy)

The government keeps on changing these policies from time to time in view of the developments taking place in the economic scenario, political expediency and the changing requirement. Every business organization has to function strictly within the policy framework and respond to the changes therein.

– **Economic System:** The world economy is primarily governed by three types of economic systems, viz., (i) Capitalist economy; (ii) Socialist economy; and (iii) Mixed economy. The type of economic system influences greatly the choice of business.

(iv) *Ecology and Physical Environment:* The ecology and physical environment plays a large part in many businesses – especially for those which carry out production and manufacturing activities. Infact, business are affected on daily basis due to enviornmental and ecological changes. For example, the impact of climate change must be considered: water and fuel costs could change dramatically, if the world warms by only a couple of degrees. The natural environment includes geographical and ecological factors that influence the business operations. These factors include the availability of natural resources, weather and climatic condition, location aspect, topographical factors, etc. For example, sugar factories are set up only at those places where sugarcane can be grown. It is always considered better to establish manufacturing unit near the sources of input. Further, government's policies to maintain ecological balance, conservation of natural resources etc. put additional responsibility on the business sector.

(v) *Political and Legal:* Political environment refers to three political institutions viz. legislature, executive and the judiciary in shaping, directing, developing and controlling business activities. The political environment of a country is influenced by the political organisations such as philosophy of political parties, ideology of government or party in power, nature and extent of bureaucracy influence of primary groups. The political environment of the country influences the business to a great extent. The political environment includes the political system, the government policies and their attitude towards the business community. All these aspects have a bearing on the strategies adopted by the business firms. The stability of the government also influences business and related activities to a great extent. It sends a signal of strength, confidence to various interest groups and investors. Further, ideology of the political party also influences the business organisation and its operations. Political changes are closely tied up with legal changes. Legal environment includes flexibility and adaptability of law and other legal rules governing the business. It may include the exact rulings and decision of the courts. These affect the business and its managers to a great extent. This refers to set of laws, regulations, which influence the business organisations and their operations. Every business organisation has to obey, and work within the framework of law. Additionally, an industry may have specific laws and regulations. For example, a pet store would deal with federal animal welfare and prohibited pet laws as wells as state laws concerning animal cruelty, housing, veterinary care and so on.

A stable political and legal environment is indispensable for business growth.

REVIEW QUESTIONS

Match the following :

	(A)		(B)
(i)	Lower Interest rate	(a)	Political factor
(ii)	Demand for Packaged Food	(b)	Technological factor
(iii)	Strike in the factory	(c)	Social factor
(iv)	New Methods of Production	(d)	Economic factor

Answers: (i)(d); (ii)(c); (iii)(a); (iv)(d).

GLOBAL INTEGRATION AND BUSINESS ENVIRONMENT

The economic environment of business in India has been changing at a fast rate mainly due to the changes in the economic policies of the government and also due to global integration. At the time of independence, the Indian economy was basically agrarian with a weak industrial base. To speed up the industrial growth and solve various economic problems, the government took several steps like state ownership on certain categories of industries, economic planning, reduced role of private sector, etc. The Government adopted several control measures on the functioning of private sector enterprises. All these efforts results in a mixed response. There was growth in net national product, per capita income and development of capital goods sector and infrastructure. But rate of industrial growth was slow, inflation increased and government faced a serious foreign exchange crisis during eighties. As a result, the government of India introduced a radical change in economic policies in 1991. This policy abolished industrial licensing in most of the cases, allowed private participation in most industries; disinvestment was carried out in many public sector industrial enterprises and opened up the economy considerably. Foreign Investment Promotion Board was set up to channel foreign capital investment in India. Let us discuss the developments under three heads, viz.,

- Liberalisation
- Privatisation
- Globalisation

Liberalisation

Liberalisation refers to the process of eliminating unnecessary controls and restrictions on the smooth functioning of business enterprises. It includes:

- Abolishing industrial licensing requirement in most of the industries
- Freedom in deciding the scale of business activities
- Freedom in fixing prices of goods and services
- Simplifying the procedure for imports and exports
- Reduction in tax rates
- Simplified policies to attract foreign capital and technology to India

Through this liberalisation process, Indian Economy has opened up and started interacting with the world in a big way. This has resulted in easy entry of foreign business organizations in India. This has further resulted in stiff competition and efficiency. Ultimately, liberalization has helped us in achieving a high growth rate, easy availability of goods at competitive rates, a healthy and flourishing stock market, high foreign exchange reserve, low inflation rate, strong rupee, good industrial relations, etc.

Privatisation

Privatization, which has become a universal trend, means transfer of ownership and/or management of an enterprise from the public sector to the private sector.

It also means the withdrawal of the state from an industry or sector, partially or fully. Another dimension of privatization is opening up of an industry that has been reserved for the public sector to the private sector.

Privatization is an inevitable historical reaction to the indiscriminate expansion of the state sector and the associated problems. Even in the 'communist' countries it became a vital measure of economic rejuvenation.

The objects are:

- To improve the performance of PSUs so as to lessen the financial burden on taxpayers
- To increase the size and dynamism of the private sector, distributing ownership more widely in the population at large
- To encourage and to facilitate private sector investments, from both domestic and foreign sources
- To generate revenues for the state
- To reduce the administrative burden on the state
- Launching and sustaining the transformation of the economy from a command to a market model

The important routes of privatization are:

- Divestiture, or privatization of ownership, through the sales of equity
- Denationalization or re privatisation

- Contracting - under which government contracts out services to other organizations that produce and deliver them
- Franchising- authorizing the delivery of certain services in designated geographical areas- is common in utilities and urban transport
- Government withdrawing from the provision of certain goods and services leaving then wholly or partly to the private sector
- Privatization of management, using leases and management contracts
- Liquidation, which can be either formal or informal. Formal liquidation involves the closure of an enterprise and the sale of its assets. Under informal liquidation, a firm retains its legal status even though some or all of its operations may be suspended

The benefits of privatization are as follows:

- It reduces the fiscal burden of the state by relieving it of the losses of the SOEs and reducing the size of the bureaucracy
- Privatization of SOEs enables the government to mop up funds
- Privatization helps the state to trim the size of the administrative machinery
- It enables the government to concentrate more on the essential state

The functions of privatization are as follows:

- Privatization helps accelerate the pace of economic developments as it attracts more resources from the private sector for development
- It may result in better management of the enterprises
- Privatization may also encourage entrepreneurship
- Privatization may increase the number of workers and common man who are shareholders. This could make the enterprises subject to more public vigilance

Due to the policy reforms announced in 1991, the expansion of public sector has literally come to a halt and the private sector registered fast growth in the post liberalised period.

The issues of privatisation include:

- reduction in the number of industries reserved for the public and the introduction of selective competition in the reserved area
- disinvestment of shares of selected public sector industrial enterprises in order to raise resources and to encourage wider participation of general public and workers in the ownership in business
- improvement in performance through an MOU system by which managements are to be granted greater autonomy but held accountable for specified results
- In India, as a result of these steps, the post liberalisation phase has witnessed a massive expansion of the private sector business in India

Globalisation

India's economic integration with the rest of the world was very limited because of the restrictive economic policies followed until 1991. Indian firms confined themselves, by and large, to the home market.

Foreign investment by Indian firms was very insignificant. With the new economic policy ushered in 1991, there has, however, been change. Globalization has in fact become a buzzword with Indian firms now and many are expanding their overseas business by different strategies.

Globalization may be defined as " the growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and of international capital flows, and also through the more rapid and widespread diffusion of technology".

Globalization may be considered at two levels viz. at the macro level (i.e., globalization of the world economy) and at the micro level (i.e., globalization of the business and the firm).

Globalization of the world economy is achieved, quite obviously, by globalizing the national economies. Globalization of the economies and globalization of business are very much interdependent.

Reasons for Globalisation

- The rapid shrinking of time and distance across the globe thanks to faster communication, speedier transportation, growing financial flows and rapid technological changes
- The domestic markets are no longer adequate rich. It is necessary to search of international markets and to set up overseas production facilities
- Companies may choose for going international to find political stability, which is relatively good in other countries
- To get technology and managerial know-how
- Companies often set up overseas plants to reduce high transportation costs
- Some companies set up plants overseas so as to be close to their raw materials supply and to the markets for their finished products
- Other developments also contribute to the increasing international of business.
- The US, Canada and Mexico have signed the North American Free Trade agreement (NAFTA), which will remove all barriers to trade among these countries
- The creation of the World Trade Organization (WTO) is stimulating increased cross-border trade

The following are the features of the current phase of globalization:

New Markets

- Growing global markets in services – banking, insurance, transport.
- New financial markets - deregulated, globally linked, working around the clock, with action at a distance in real time, with new instruments such as derivatives.
- Deregulation of anti - trust laws and proliferation of mergers and acquisitions.
- Global consumer markets with global brands

New Rules and Norms

- Market economic policies spreading around the world, with greater privatization and liberalization than in earlier decades
- Widespread adoption of democracy as the choice of political regime
- Human rights conventions and instruments building up in both coverage and number of signatories – and growing awareness among people around the world
- Consensus goals and action agenda for development

– Conventions and agreements on the global environment – biodiversity, ozone layer, disposal of hazardous wastes, desertification, climate change

– Multilateral agreements in trade, taking on such new agendas as environmental and social conditions

– New multilateral agreements- for services, intellectual property, communications – more binding on national governments than any previous agreements

– The multilateral agreements on investment under debate

LESSON ROUND UP

– Business may be understood as the organized efforts of enterprise to supply consumers with goods and services for a profit. There is a close and continuous interaction between the business and its environment.

– A Vision Statement describes the desired future position of the company.

– A Mission Statement defines the company's business, its objectives and its approach to reach those objectives.

– Business Environment is mainly of two types.

– Internal environment contain

- Human Resource
- Financial Factors
- Marketing Resources
- Physical Assets
- Management Structure and Nature
- Research and Development
- Company Image and Brand Equity
- Value System
- Competitive Advantage

– External Environment comprises of all entities that exist outside its boundaries, but have significant influence over its growth and survival.

– There are two types of external environment

- Micro/Operating Environment
- Macro/General Environment

– Micro environmental factors include:

- Customers
- Employees
- Suppliers
- Shareholders
- Media

- Competitors

– Macro environment is primarily concerned with major issues and upcoming changes in the environment.

- Socio-Cultural and Demographics
- Technology
- Economic Conditions
- Ecology and Physical Environment
- Political and Legal

– The economic environment of business in India has been changing at a fast rate mainly due to the changes in the economic policies of the government and also due to global integration.

- Liberalisation
- Privatisation
- Globalisation

GLOSSARY

Business	An economic activity, which is related with continuous and regular production and distribution of goods and services for satisfying human wants.
Business Environment	Business Environment may be defined as a set of conditions – Social, Legal, Eco nomical, Political or Institutional that are uncontrollable in nature and affects the functioning of organization. It is the surrounding of the business.
First Mover Advantage	A form of competitive advantage that a company earns by being the first to enter a specific market or industry. Being the first allows a company to acquire superior brand recognition and customer loyalty. The company also has more time to perfect its product or service.
Image Building	The perception that is created in people's mind about the image of the business or entrepreneurial activity that they instantly recognise the name as they hear it. A business's image is composed of an infinite variety of facts, events, personal histo ries, advertising and goals that work together to make an impression on the public.
Mission Statement	A mission statement is a brief description of a company's fundamental purpose. A mission statement answers the question, "Why do we exist?"
Vision Statement	A vision statement is a picture of a company in the future which is a inspirational note and the framework for all strategic planning. A vision statement answers the question, "Where do we want to go?"
Competitive Advantage	A competitive advantage is an advantage over competitors gained by offering con sumers greater value, either by means of lower prices or by providing greater benefits and service that justifies higher prices.
Value System	A coherent set of values adopted or evolved by a person, organization, or society as a standard to guide its behavior in preferences in all situations.
Industrial Licensing	It is the policy measure adopted by the government to meet pre defined objectives where specified industries need to take license from government to start business.

SELF-TEST QUESTIONS

1. What is Business? Discuss its essential characterstics.
2. How are mission and vision statement significant in business environment?
3. What are different types of business environment?
4. Distinguish between:
   (i) Internal and External Business Environment
   (ii) Micro and Macro Business Environment
5. What do you understand by liberalisation? Give its objectives.
6. What do you understand by privatisation? Give its objectives.
7. What do you understand by globalisation? Give its objectives.
8. What are the gains that business experiences from global integration?

Suggested Reading

(i) Francis Cherunilam- Business Environment –Text and Cases, Himalaya Publishing House.

Lesson 2
Forms of Business Organisation

LESSON OUTLINE

- Introduction
- Characteristics of an Ideal Form of Organization
- Forms of Business Organisation
- Sole Proprietorship
- HUF and Family Business
- Review Questions
- Partnership
- Company
- Review Questions
- Statutory Bodies and Corporations
- Cooperatives, Societies and Trusts
- Limited Liability Partnership
- Differences between Various Forms of Business Organisation
- Choice of an Appropriate Form of Business
- Other Corporation Classifications
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

After deciding to start a business (and the particular business to pursue), one of the important issues is the form of business entity that will serve as the vehicle in pursuing the business. Business ranges in size from sole proprietor at one extreme to the large multinational on the other which employs thousands of people over several countries.

The size structure of the business will depend on many factors which range from internal to external factors which are beyond the control of the firm.

This lesson deals with various forms of business, elaborating on characteristics, advantages and disadvantages of each. This enables new businessmen to evaluate the form which would suit best to the type of business, he would be planning to set up.

This is necessary because it is widely known that right form of business organisation is largely responsible for the success of an enterprise.

The message from Wal-Mart today to the rest of the business community is there need not be any conflict between the environment and the economy. We will find the way not only to reconcile (those), but to find new profits and new opportunities as we do the right thing.

Al Gore

INTRODUCTION

Business activities consist of industrial and commercial activities. Business organizations are units that undertake these activities. They can be also called as business undertaking, enterprises, concerns or firms. A business organization can be better understood by analyzing its characteristics.

(i) *Distinct Ownership:* The term ownership refers to the right of an individual or a group of individuals to acquire legal title to assets or properties for the purpose of running the business. A business firm may be owned by one individual or a group of individuals jointly.

(ii) *Lawful Business:* Every business enterprise must undertake such business which is lawful, that is, the business must not involve activities which are illegal.

(iii) *Separate Status and Management:* Every business undertaking is an independent entity. It has its own assets and liabilities. It has its own way of functioning. The profits earned or losses incurred by one firm cannot be accounted for by any other firm.

(iv) *Dealing in Goods and Services:* Every business undertaking is engaged in the production and/or distribution of goods or services in exchange of money.

(v) *Continuity of Business Operations:* All business enterprise engage in operation on a continuous basis. Any unit having just one single operation or transaction is not a business unit.

(vi) *Risk Involvement:* Business undertakings are always exposed to risk and uncertainty. Business is influenced by future conditions which are unpredictable and uncertain. This makes business decisions risky, thereby increasing the chances of loss arising out of business.

Business concerns are established with the objective of making profits. They can be established either by one person or by a group of persons in the private sector by the government or other public bodies in the public sector. A business started by only one person is called sole proprietorship. The business started by a group of persons can be either a Hindu Undivided Family or Partnership or Company or a Co-operative form of organization.

Business organisation refers to all necessary arrangements required to conduct a business. It refers to all those steps that need to be undertaken for establishing relationship between men, material, and machinery to carry on business efficiently for earning profits. This may be called the process of organizing. The arrangement which follows this process of organizing is called a business undertaking or organisation. While establishing the business the most important task is to select a proper form of organization. The right form of business organization is largely responsible for the success of an enterprise. The conduct of business, its control, acquisition of capital, distribution of profit, legal formalities etc depend on the form of organization.

CHARACTERISTICS OF AN IDEAL FORM OF ORGANIZATION

The characteristics of an ideal form of organization are found in varying degrees in different forms of organization. The entrepreneur, while selecting a form of organization for his business, should consider the following factors. Before selecting a suitable form of commercial organization, entrepreneur[s]will have to consider a number of factors. The choice of the form of commercial organization largely depends upon the following factors.

(i) *Ease of Formation:* It should be easy to form the organization. The formation should not involve many legal formalities and it should not be time consuming.

(ii) *Adequacy of Capital:* The form of organization should facilitate the raising of the required amount of capital at a reasonable cost. If the enterprise requires a large amount of capital, the preconditions for attracting capital from the public are a) safety of investment b) fair return on investment and c) transferability of the holding.

(iii) *Limit of Liability:* A business enterprise may be organized on the basis of either limited or unlimited liability. From the point of view of risk, limited liability is preferable. It means that the liability of the owner as regards the debts of the business is limited only to the amount of capital agreed to be contributed by him. Unlimited liability means that even the owners' personal assets will be liable to be attached for the payment of the business debts.

(iv) *Direct relationship between Ownership, Control and Management:* The responsibility for management must be in the hands of the owners of the firm. If the owners have no control on the management, the firm may not be managed efficiently.

(v) *Continuity and Stability:* Stability is essential for any business concern. Uninterrupted existence enables the entrepreneur to formulate long-term plans for the development of the business concern.

(vi) *Flexibility of Operations:* another ideal characteristic of a good form of organization is flexibility of operations. Changes may take place either in market conditions or the states' policy toward industry or in the conditions of supply of various factors of production. The nature of organization should be such as to be able to adjust itself to the changes without much difficulty.

(vii) *Distinct Ownership:* The term ownership refers to the right of an individual or a group of individuals to acquire legal title to assets or properties for the purpose of running the business. A business firm may be owned by one individual or a group of individuals jointly.

(viii) *Lawful Business:* Every business enterprise must undertake such business which is lawful, that is, the business must not involve activities which are illegal.

(ix) *Separate Status and Management:* Every business undertaking is an independent entity. It has its own assets and liabilities. It has its own way of functioning. The profits earned or losses incurred by one firm cannot be accounted for by any other firm.

(x) *Dealing in Goods and Services:* Every business undertaking is engaged in the production and/or distribution of goods or services in exchange of money.

(xi) *Continuity of Business Operations:* All business enterprise engage in operation on a continuous basis. Any unit having just one single operation or transaction is not a business unit.

(xii) *Risk Involvement:* Business undertakings are always exposed to risk and uncertainty. Business is influenced by future conditions which are unpredictable and uncertain. This makes business decisions risky, thereby increasing the chances of loss arising out of business.

FORMS OF BUSINESS ORGANISATION

Forms of business organization are legal forms in which a business enterprise may be organized and operated. These forms of organization refer to such aspects as ownership, risk bearing, control and distribution of profit.

The most important forms of business organisation are as follows:

- Sole Proprietorship
- Hindu Undivided Family Business
- Partnership
- Company
- Statutory Bodies and Corporations
- Co-Operatives, Societies and Trusts
- Limited Liability Partnership

Any one of the above mentioned forms may be adopted for establishing a business, but usually one form is more suitable than other for a particular enterprise. The choice will depend on various factors like the nature of business, the objective, the capital required, the scale of operations, state control, legal requirements and so on.

SOLE PROPRIETORSHIP

We go to the market to buy items of our daily needs. In the market we find a variety of shops- some of them small and some of them big. We may find some persons selling vegetables, peanuts, newspapers etc. on the roadside. We may also find cobbler repairing shoes on the footpath. Everyday you come across such types of shops in your locality. But have you ever tried to know how these businesses are run? Who are the owners of these businesses? What exactly does an owner do for any business? You may say, the owner invests capital to start the business, takes all decisions relating to business, looks after the day to day functioning of the business and finally, is responsible for the profit or loss. Yes, you are right. The owner does exactly all these things. In such type of business the single individual takes all initiatives to start and run the business. 'Sole' means single and 'proprietorship' means ownership. It means only one person or an individual becomes the owner of the business. Thus, the business organisation in which a single person owns, manages and controls all the activities of the business is known as sole proprietorship form of business organisation. The individual who owns and runs the sole proprietorship business is called a ‘sole proprietor’ or ‘sole trader’. A sole proprietor pools and organizes the resources in a systematic way and controls the activities with the sole objective of earning profit. Is there any such shop near your locality where a single person is the owner? Small shops like vegetable shops, grocery shops, telephone booths, chemist shops, etc. are some of the commonly found sole proprietorship form of business organisation. Apart from trading business, small manufacturing units, fabrication units, garages, beauty parlors, etc., can also be run by a sole proprietor. This form of business is the oldest and most common form of business organisation. Thus, sole proprietorship can be defined as “a business enterprise exclusively owned, managed and controlled by a single person with all authority, responsibility and risk”.

Characteristics

Sole proprietorship form of business organizations have the following characteristics:

(i) *Single Ownership:* A single individual always owns sole proprietorship form of business organization. That individual owns all assets and properties of the business. Consequently, he alone bears all the risk of the business. Thus, the business of the sole proprietor comes to an end at the will of the owner or upon his death.

(ii) *No sharing of Profit and Loss:* The entire profit arising out of sole proprietorship business goes to the sole proprietor. If there is any loss it is also to be borne by the sole proprietor alone. Nobody else shares the profit and loss of the business with the sole proprietor.

(iii) *One-man’s Capital:* The capital required by a sole proprietorship form of business organisation is totally arranged by the sole proprietor. He provides it either from his personal resources or by borrowing from friends, relatives, banks or other financial institutions.

(iv) *One-man Control:* The controlling power in a sole proprietorship business always remains with the owner. The owner or proprietor alone takes all the decisions to run the business. Of course, he is free to consult any body as per his liking.

(v) *Unlimited Liability:* The liability of the sole proprietor is unlimited. This implies that, in case of loss the business assets along with the personal properties of the proprietor shall be used to pay the business liabilities.

(vi) *Less Legal Formalities:* The formation and operation of a sole proprietorship form of business organisation requires almost no legal formalities. It also does not require to be registered. However, for the purpose of the business and depending on the nature of the business, the sole proprietorship has to have a seal. He may be required to obtain a license from the local administration or from the health department of the government, whenever necessary.

Advantages of Sole Proprietorship

The sole proprietorship form of business is the most simple and common in our country.

It has the following advantages:

(i) *Easy to Form and Wind up:* A sole proprietorship form of business is very easy to form. With a very small amount of capital you can start the business. There is no need to comply with any legal formalities except for those businesses which required license from local authorities or health department of government. Just like formation it is also very easy to wind up the business. It is your sole discretion to form or wind up the business at any time.

(ii) *Direct Motivation:* The profits earned belong to the sole proprietor alone and bears the risk of losses as well. Thus, there is a direct link between effort and reward. If he works hard, then there is a possibility of getting more profit and of course, he will be the sole beneficiary of this profit. Nobody will share this reward with him. This provides strong motivation for the sole proprietor to work hard.

(iii) *Quick Decision and Prompt Action:* In a sole proprietorship business the sole proprietor alone is responsible for all decisions. Of course, he can consult others. But he is free to take any decision on his own. Since no one else is involved in decision making it becomes quick and prompt action can be taken on the basis of this decision.

(iv) *Better Control:* In sole proprietorship business the proprietor has full control over each and every activity of the business. He is the planner as well as the organizer, who co-ordinates every activity in an efficient manner. Since the proprietor has all authority with him, it is possible to exercise better control over business.

(v) *Maintenance of Business Secrets:* Business secrecy is an important factor for every business. It refers to keeping the future plans, technical competencies, business strategies, etc, secret from outsiders or competitors. In the case of sole proprietorship business, the proprietor is in a very good position to keep his plans to himself since management and control are in his hands. There is no need to disclose any information to others.

(vi) *Close Personal Relation:* The sole proprietor is always in a position to maintain good personal contact with the customers and employees. Direct contact enables the sole proprietor to know the individual likes, dislikes and tastes of the customers. Also, it helps in maintaining close and friendly relations with the employees and thus, business runs smoothly.

(vii) *Flexibility in Operation:* The sole proprietor is free to change the nature and scope of business operations as and when required as per his decision. A sole proprietor can expand or curtail his business according to the requirement. Suppose, as the owner of a bookshop, you have been selling books for school students. If you want to expand your business you can decide to sell stationery items like pen, pencil, register, etc. If you are running an STD booth, you can expand your business by installing a fax machine in your booth.

(viii) *Encourages Self-employment:* Sole proprietorship form of business organization leads to creation of employment opportunities for people. Not only is the owner self-employed, sometimes he also creates job opportunities for others. You must have observed in different shops that there are a number of employees assisting the owner in selling goods to the customers. Thus, it helps in reducing poverty and unemployment in the country.

Disadvantages of Sole Proprietorship

One-man business is the best form of business organisation because of the above discussed advantages. Still there are certain disadvantages too.

Let us learn those limitations.

(i) *Limited Capital:* In sole proprietorship business, it is the owner who arranges the required capital of the business. It is often difficult for a single individual to raise a huge amount of capital. The owner's own funds as well as borrowed funds sometimes become insufficient to meet the requirement of the business for its growth and expansion.

(ii) *Unlimited Liability:* In case the sole proprietor fails to pay the business obligations and debts arising out of business activities, his personal properties may have to be used to meet those liabilities. This restricts the sole proprietor from taking risks and he thinks cautiously while deciding to start or expand the business activities.

(iii) *Lack of Continuity:* The existence of sole proprietorship business is linked to the life of the proprietor. Illness, death or insolvency of the owner brings an end to the business. The continuity of business operation is therefore uncertain.

(iv) *Limited Size:* In sole proprietorship form of business organisation there is a limit beyond which it becomes difficult to expand its activities. It is not always possible for a single person to supervise and manage the affairs of the business if it grows beyond a certain limit.

(v) *Lack of Managerial Expertise:* A sole proprietor may not be an expert in every aspect of management. He/she may be an expert in administration, planning, etc., but may be poor in marketing. Again, because of limited financial resources it is also not possible to employ a professional manager. Thus, the business lacks benefits of professional management.

Let us consider the type of businesses where sole proprietorship form is most suitable.

Sole proprietorship form of business organisation is suitable:

– Where the market for the product is small and local. For example, selling grocery items, books, stationery, vegetables, etc.

– Where customers are given personal attention, according to their personal tastes and preferences. For example, making special type of furniture, designing garments, etc.

– Where the nature of business is simple. For example, grocery, garments business, telephone booth, etc.

– Where capital requirement is small and risk involvement is not heavy. For example, vegetables and fruits business, tea stalls etc.

– Where manual skill is required. For example, making jewellery, haircutting or tailoring.

REVIEW QUESTIONS

State True or False about sole proprietorship :

1. The business is started by one person.
2. It is managed by employees of the business.
3. It is suitable for manufacturing of steel.
4. Sole proprietorship business includes only shopkeepers.
5. The risk of the business is shared with the employees of the business.

Answers: 1. True 2. False 3. False 4. True 5. False

HINDU UNDIVIDED FAMILY

Meaning

The Hindu Undivided Family (HUF) business is a form of business organization found only in India. In this form of business, all the members of a Hindu undivided family own the business jointly. The affairs of business are managed by the head of the family, who is known as the "KARTA". A Hindu Undivided Family business comes into existence as per the Hindu Inheritance Laws of India. In a Hindu Undivided Family business only the male members get a share in the business by virtue of their being part of the family. The membership is limited up to three successive generations. Thus, an individual, his sons(s), and his grandson(s) become the members of a Hindu Undivided Family by birth. They are also called "Co-parceners". The term co-parceners imply that such an individual has got the right to ask for a partition of the Hindu Undivided Family business and to have his separate share. A daughter has no right to ask for a partition and is, therefore, not a co-parcener.

In the entire Hindu joint family, the karta or manager (the English word manager is wholly inadequate in understanding his unique position) occupies a very important position. Karta is the eldest male member of the family. He is the Hindu patriarch. Only a coparcener can become Karta. Such unique is his position that there is no office or any institution or any other system of the world, which can be compared with it. His position is sui generis i.e. of his own kind or peculiar to himself. Peculiarity lies in the fact that in terms of his share/interest, the Karta is not superior and has no superior interests in the coparcenery. If partition takes place he is entitled to take his share. He is a person with limited powers, but, within the ambit of his sphere, he possesses such vast powers as are possessed by none else. His position is recognized /conferred by law. No stranger can ever be qualified to be a karta, but an adopted son who is the eldest in the family can be qualified. In a HUF, the responsibility of Karta is to manage the HUF property. He is the custodian of the income and assets of the HUF. He is liable to make good to other family members with their shares of all sums which he has misappropriated or which he spent for purposes other than those in which the joint family was interested. His role is crucial. He is entrusted not only with the management of land/assets of the family but also is entrusted to do the general welfare of the family.

Characteristics

(i) *Legal Status:* The Hindu Undivided Family business is a jointly owned business just like a jointly owned property. It is governed by Hindu Law. It can enter into partnership agreement with others.

(ii) *Membership:* There is no membership other than the members of the joint family. Inside the family also, it is restricted only to male members who are co-parceners by birth.

(iii) *Profit Sharing:* All co-parceners have equal share in the profits of the business. In the event of death of any of the co-parcener, his wife can claim share of profit.

(iv) *Management:* The management of a Hindu Undivided Family business is in the hands of the senior-most family member who is known as the karta. He has the authority to manage the business and his ways of managing can not be questioned by the co-parceners.

(v) *Liability:* The liability of each member of the Hindu Undivided Family business is limited to the extent of his share in the business. But the liability of the karta is unlimited as, it extends to his personal property.

(vi) *Fluctuating Share:* The individual share of each co-parcener keeps on fluctuating. This is because, every birth of a male child in the family adds to the number of co-parceners and every death of a co-parcener reduces the number.

(vii) *Continuity:* A Hindu Undivided Family business continues to exist on the death of any co-parcener. Even on the death of the karta, it continues to exist as the next senior most family member becomes karta.

However, a Hindu Undivided Family business can be dissolved any time either through mutual agreement between members or by partition.

Advantages of Joint Hindu Family Business

(i) *Assured Share in Profits:* Every co-parcener is assured a share in the profits irrespective of his contribution to the successful running of the business. This, in a way safeguards the interests of some members of the family like minors, sick, disabled and widows.

(ii) *Freedom in Managing:* The karta enjoys full freedom in conducting the family business. It enables him to take quick decisions without much interference.

(iii) *Sharing of Knowledge and Experience:* A Hindu Undivided Family business provides opportunity for the young members of the family to get the benefit of knowledge and experience of the elder members and also helps in inculcating virtues like discipline, self-sacrifice, tolerance etc.

(iv) *Unlimited Liability of the Karta:* The liability of the co-parceners is limited, except for that of the karta. This makes the karta to manage the business in the most efficient manner.

(v) *Continued Existence:* A Hindu Undivided Family business is not affected by the insolvency or death of any member including that of karta. Thus, it can continue for a long period of time.

Disadvantages of Joint Hindu Family Business

(i) *Limited Resources:* Hindu Undivided Family business has generally limited financial and managerial resource. Therefore, it can not undertake big and risky business.

(ii) *Lack of Motivation:* There is always a lack of motivation among the members to work hard. It is because the benefit of hard work does not go entirely to any individual member but shared by all the co-parceners.

(iii) *Scope for Misuse of Power by the Karta:* Since the karta has absolute freedom to manage the business, there is scope for him to misuse it for his personal gains. An inefficient karta can also do harm to the business.

(iv) *Scope for Conflict:* In a Hindu Undivided Family business the male members of three successive generations are involved. It always leads to conflict between generations.

(v) *Instability:* The continuity of business is always under threat. It may be due to a small rift within the family and if a co-parcener asks for a partition the business is closed.

Suitability of Joint Hindu Family Business

The success of Hindu Undivided Family business is mostly dependent upon the efficiency of the karta and the mutual understanding between the co-parceners. Nevertheless, this type of business is losing its ground with the gradual decline in the Hindu Undivided Family system.

REVIEW QUESTIONS

State True or False:

1. Anybody can be a member of a joint hindu family business.
2. The liability of the karta is unlimited.
3. A joint hindu family business continues to exist on the death of a co-parcener.
4. A joint hindu family business ceases to exist on the death of the Karta.
5. A joint hindu family business comes into existence by hindu law

Answers: 1. False 2. False 3. False 4. True 5. False

PARTNERSHIP

Meaning

Partnership is an association of two or more individuals (but not more than 20) who agree to share the profits of a lawful business which is managed and carried on either by all or by any, or some of them acting for all. According to Haney, "Partnership is the relation between persons competing to make contract who agree to carry on a lawful business In common with a view of private gain." The formation of partnership is easy and simple. It is formed to meet the need for" more capital, effective supervision and control, greater specialization, division of work between proprietors and for spreading of risk Persons from similar background or persons of different ability and skills, may join together to carry on a business. Each member of such a group is individually known as 'partner' and collectively the members are known as a 'partnership firm'. These firms are governed by the Indian Partnership Act, 1932.

Characteristics

(i) *Number of Partners:* A minimum of two persons are required to start a partnership business. The maximum membership limit is 10 in case of banking business and 20 in case of all other types of business.

(ii) *Contractual Relationship:* The relation between the partners of a partnership firm is created by contract. The partners enter into partnership through an agreement which may be verbal, written or implied. If the agreement is in writing it is known as a 'Partnership Deed'.

(iii) *Competence of Partners:* Since individuals have to enter into a contract to become partners, they must be competent enough to do so. Thus, minors, lunatics and insolvent persons are not eligible to become partners. However, a minor can be admitted to the benefits of partnership i.e. he can have a share in the profits.

(iv) *Sharing of Profit and Loss:* The partners can share profit in any ratio as agreed. In the absence of an agreement, they share it equally.

(v) *Unlimited Liability:* The partners have unlimited liability. They are liable jointly and severally for the debts and obligations of the firm. Creditors can lay claim on the personal properties of any individual partner or all the partners jointly. Even a single partner may be called upon to pay the debts of the firm. Of course, he can get back the money due from other partners. The liability of a minor is, however, limited to the extent of his share in the profits, in case of dissolution of a firm.

(vi) *Principal-Agent Relationship:* The business in a partnership firm may be carried on by all the partners or any one of them acting for all. This means that every partner is an agent when he is acting on behalf of others and he is a principal when others act on his behalf. It is, therefore, essential that there should be mutual trust and faith among the partners in the interest of the firm.

(vii) *Transfer of Interest:* No partner can sell or transfer his interest in the firm to anyone without the consent of other partners.

(viii) *Legal Status:* A partnership firm is just a name for the business as a whole. The firm means partners and the partners mean the firm. Law does not recognize the firm as a separate entity distinct from the partners.

(ix) *Voluntary Registration:* Registration of partnership is not compulsory. But since registration entitles the firm to several benefits, it is considered desirable. For example, if it is registered, any partner can file a case against other partners, or a firm can file a suit against outsiders in case of disputes, claims, disagreements, etc.

(x) *Dissolution of Partnership:* Dissolution of partnership implies not only a complete closure or termination of partnership business, but it also includes any change in the existing agreement among the partners due to a change in the number of partners.

Advantages of Partnership Firm

(i) *Easy to Form:* The partnership, like the sole proprietorship, can be easily organized. There are no complicated legal formalities involved in the establishment of partnership business. The partners enter into a partnership agreement and start business.

(ii) *Favorable Credit Standing:* The partnership enjoys a better credit rating in the eyes of creditors. As the liability of each partner in the organization is unlimited the financial institution can safely advance loans to the firms.

(iii) *Large Capital:* In case of sole proprietorship, the capital is limited to the savings of one owner or his borrowing capacity. Partnership can bring more capital to the business by the joint efforts of the partners. The partnership is normally in strong position to raise capita and expand the business.

(iv) *Greater Management Ability:* As there are many partners involved in the operation of a business, the firm can distribute the duties and responsibilities to each partner for which one is best qualified and suited. Division of labour and specialization, thus, can promote efficiency of the firm.

(v) *Union of Business Ability:* There is a bid age saying that two heads are better than one. In case of partner the partner mutually consults each other about the lay out, production procedure, marketing channels, etc. and as a result, a wise course of procedure results.

(vi) *Profit Incentive:* The profits are shared by the partners as per agreement. They are encouraged to do more work to earn more profit. Higher the profits, higher will be the partners share.

(vii) *Advantages of Secrecy:* The partners can keep the business secrets to themselves. The firm is not required by law to publish its profit and loss account and balance sheet.

(viii) *Retention of a Skilled Worker:* If an employee in the partnership business is found to be a man of outstanding talent and ability, he with the mutual consultation of other partners can be given a status of a partner in the business.

(ix) *Brake on Hasty Decisions:* As liability of partners is unlimited, the partners, therefore, tend to be careful in taking business decisions. They adopt sound practices in the conduct of business. There is a brake on hasty decisions.

(x) *Special Protection to Minor:* A death or lunacy of a partner may not cause dissolution of the partnership. His minor can be admitted only to the benefits of partners with the consent of other partners.

(xi) *Increase in the Spirit of Co-operation:* The success of business depends upon mutual trust and cooperation of the partners. The partners are fully aware that a sight difference can cause the end of partnership. This increases in them the sprit of working together.

(xii) *Tax Advantage:* The profits of a registered firm, after payment of super fax, are divided among the partners. They pay tax to the government on their shares of profit. Thus the partners of registered firm get the benefit of lower assessment.

(xiii) *Ease of Dissolution:* The partnership can also be legally dissolved much difficult by mutual consent of the partners or in accordance with a contract by the partners. There are no formal documents required to be drawn up as in the case of a joint stock company.

Disadvantages of Partnership Firm

The partnership form of organization suffers from certain disadvantages also. These in brief are as follows.

(i) *Unlimited Liability of Partners:* One of the basic defects of partnership is that the partners are personally and jointly responsible for all the debts of the firm. In case the business suffers losses and the business assets are not sufficient to satisfy the claimants on liquidation, the personal property of one or more than one partners can be sold under the Court order for the clearance of the debts of the business. The rich and wealthy persons, therefore, avoid to be enlisted in partnership because each individual partner in liable for the firm's debt.

(ii) *Limited Life of Firm:* The duration of the partnership is always uncertain. I partner dies, injured, withdraws, sells his interest, or a new partner is admitted into the business, or their arises difference, the partnership may come td an end. There are every possibilities of the dissolution of the firm due to internal differences.

(iii) *Frozen Investment:* It is very easy for a partner to invest money but it is most difficult to withdraw the investment from the business. A person who wishes to withdraw investment has to consult his partners, find a substitute with equal business ability. Unless the above conditions are fulfilled, the funds remain difficult to transfer and as such remain a frozen investment which creates lack of interest.

(iv) *Disputes Among the Partners:* The partners should be like minded, have a common objective, be large hearted, have a cool temperament, should not unnecessarily cause friction and confusion among the partners. The choosing of partner is in fact like choosing a wife. Marry in haste and repent in leisure. In case of dispute among the partners, quick action should be taken by all the partners for the remedial measures.

(v) *Possibility of Misuse of Resources:* It is known to each and every partner that the resources of the firm are owned jointly. There can and does arise the misuse of resources by a partner/partners.

(vi) *Loss of Business Opportunities:* In case of differences among the "partners, a delay may take place in decision-making. This can cause loss to the firm.

(vii) *Divided Control:* In a partnership, the work of the business is divided among the partners according to their ability, choice and taste. Divided control - and responsibility sometimes creates confusion and delay in making decisions. The lack of efficiency on the part of one partner can upset the whole structure of the business and ultimately lead to dissolution of the firm.

(viii) *Lack of Public Confidence:* Partnership form of organization may not enjoy public confidence due to lack of publicity and absence of regulations.

(ix) *Implied Authority:* Implied authority is the authority vested in a partner to bind the firm with any of his acts done in connection with the business of the firms. In partnership form of organization, each partner binds other partners by his acts done on behalf of the firm: Thus the other partners may have to pay for the follies and dishonesty of a fellow partner.

Suitability of Partnership Firm

In a partnership firm, persons from different walk of life having ability, managerial talent and skill join together to carry on a business. This increases the administrative strength of the organisation, the financial resources, the skill and expertise, and reduces risk. Such firms are most suitable for comparatively small business such as retail and wholesale trade, professional services, medium sized mercantile houses and small manufacturing units. Generally it is seen that many organizations are initially started as partnership firms and later, when it is economically viable and financially attractive for the investors, it is converted into a company.

REVIEW QUESTIONS

Fill in the Blanks:

1. A partnership firm requires at least .... persons.
2. The partners are liable .... and .... for all the debts and obligations of the firm.
3. Registration of a partnership firm is ....
4. There exists a .... relationship between partners.
5. The persons who own the partnership business are individually called .... and collectively known as ....

Answers: 1. two 2. Jointly, severally 3. not compulsory 4. contractual 5. partners, firm

COMPANY

Meaning

A Company form of business organisation is a voluntary association of persons to carry on business. Normally, it is given a legal status and is subject to certain legal regulations. It is an association of persons who generally contribute money for some common purpose. The money so contributed is the capital of the company. The persons who contribute capital are its members. The proportion of capital to which each member is entitled is called his share, therefore members of a company are known as shareholders and the capital of the company is known as share capital. The total share capital is divided into a number of units known as 'shares'. You may have heard of the names of companies like Tata Iron & Steel Co. Limited, Hindustan Lever Limited, Reliance Industries Limited, Steel Authority of India Limited, Ponds India Limited etc.

The companies are governed by the Indian Companies Act, 2013. The Act defines a company as an artificial person created by law, having separate entity, with perpetual succession and a common seal. As per Companies Act 2013, a company is formed and registered under the Companies Act or an existing company registered under any other Act".

Characteristics

Following are the main characteristics of a company:

(i) *Artificial Legal Person:* A company is an artificial person as it is created by law. It has almost all the rights and powers of a natural person. It can enter into contract. It can sue in its own name and can be sued.

(ii) *Incorporated Body:* A company must be registered under Companies Act. By virtue of this, it is vested with corporate personality. It has an identity of its own. Although the capital is contributed by its members called shareholders yet the property purchased out of the capital belongs to the company and not to its shareholders.

(iii) *Capital Divisible into Shares:* The capital of the company is divided into shares. A share is an indivisible unit of capital. The face value of a share is generally of a small denomination which may be of Rs 10, Rs 25 or Rs 100.

(iv) *Transferability of Shares:* The shares of the company are easily transferable. The shares can be bought and sold in the stock market.

(v) *Perpetual Existence:* A company has an independent and separate existence distinct from its share holders. Changes in its membership due to death, insolvency etc. does not affect its existence and its continuity.

(vi) *Limited Liability:* The liability of the shareholders of a company is limited to the extent of face value of shares held by them. No shareholder can be called upon to pay more than the face value of the shares held by them. At the most the shareholders may be asked to pay the unpaid value of shares.

(vii) *Representative Management:* The number of shareholders is so large and scattered that they cannot manage the affairs of the company collectively. Therefore they elect some persons among themselves to manage and administer the company. These elected representatives of shareholders are individually called the 'directors' of the company and collectively the Board of Directors.

(viii) *Common Seal:* A common seal is the official signature of the company. Any document bearing the common seal of the company is legally binding on the company.

Advantages of Company

(i) *Greater Permanency:* The life of a joint stock company compared to the partnership is very stable. If the business remains well managed, it can live on indefinitely. The life of a company is not affected by the death, disability, insolvency or disagreement of a shareholder. The shareholders, may come or go, the life of the company like an artificial person' is least affected by these changes. There is, thus, a greater permanency of the joint stock companies.

(ii) *Limited Liability:* In a joint stock company, all the shareholders have a limited liability. In case of loss to the company, the liability of the shareholders is limited to the amounts; they have invested in the company.

(iii) *Easy to Transfer Ownership:* One of the basic features of joint stock company is that the shareholders can transfer the ownership of shares to the interested parties' through the share brokers. The company simply records change of ownerships. This facility provides liquidity to the investors and stability to the company.

(iv) *Attraction of Huge Capital:* The joint stock companies divide the share capital into shares of small denominations in order to attract capital from large number of investors for starting big business and industrial enterprises.

(v) *Management Functions:* In a joint stock company, the management activities are divided according to functions. The company employs 'specialists' in each department to do specific type of work, of purchase, sale, and manufacturing, finance etc. under the supervision of directors of the company. The availability of highly skilled managerial talent, thus, gives greater permanence and co to the company.

(vi) *Recognized Legal Entity:* The joint stock company is incorporated under the Companies Ordinance. In all legal matters, therefore, it is dealt with as an individual person. The company can enter into contracts; borrow money, open banking account in its name. It can sue or be sued, hold, deal and dispose of property in its own name

(vii) *Higher Profits:* Due to availability of large capital, the company installs expensive and up to date machinery. There is thus greater production of goods. The cost is reduced and the firm can earn higher profits by producin9 better quality of goods.

(viii) *Benefits of Large Scale Production:* The company due to the increase in the size of business enjoys all the economies of large scale production.

(ix) *Bold Management:* This type of organization can undertake big risks which sole proprietorship or partnership form of organizations cannot do.

(x) *Spread of Risk:* In a company form of organization, the risk is distributed among large number of shareholders. From the point of view of an investor, it is a great advantage.

(xi) *Democratic Organization:* The management of the company is carried on by the elected board of directors on behalf of and for the shareholders of the company. Thus, the organization of the company is democratic.

(xii) *Full Legal Cover:* There is full legal cover on the activities of a company from the birth, to its liquidation. People have, therefore, greater 'confidence in companies than they have in sole trading or a partnership.

(xiii) *Social Benefits:* Joint stock companies have made it possible for the persons of low income groups to invest in productive activity under unified management. The number of the poor "is thus moving up into the levels of middle income groups.".

Disadvantages of Company

There is no doubt that joint stock company enjoys certain distinct advantages of limited liability, greater permanence etc. but there are also certain abuses/draw backs which are associated with the joint stock company. They, in brief, are as follows:

(i) *Formation of a Company Complicated:* The formation of a joint stock company is much more complicated than sole proprietorship or partnership. There are many legal formalities, which are to be observed which consume a greater amount of time, energy and the money also.

(ii) *Double Taxation:* The joint stock company is subject to doubt taxation. It pays tax on its earnings to the government. The tax is also paid by the share holders on the receipt of dividend from the company. This amounts to taxing the earnings of company twice Double taxation of earnings is considered to be a barrier to-the capital formation in the country.

(iii) *Exploitation of Shareholders:* The shareholders of a company mostly remain unknown to one another. Most of them have neither time nor the technical knowledge to know the affairs of the business where they have invested a part of their savings. They seldom attend the annual meetings. The control of the company, therefore, generally remains in the hands of promoters who are elected as directors of the company by the interested shareholders every year. The concentration of control in a few hands can and often leads to exploitation of the shareholders. If the company is suffering losses, they sell their shares and shift the burden to the new shareholders. If it is expected to earn profits, they purchase the shares and earn maximum return.

(iv) *Separation of Ownership from Control:* In a joint stock company, the shareholders who are real investors are not allowed to take part in the operations of the business. There is thus a separation of ownership from control. The directors in collaboration with the managers often exploit the helpless shareholders.

(v) *Promotion of Frauds:* The joint stock company is incorporated, by taking definite legal steps. If the promoters are dishonest and want to exploit the scattered shareholders, they give a very rosy picture of high profits ri the prospectus. The window dressing of the prospectus often misleads the investors who are later on exploited by the promoters: This shakes the confidence of the investors in other sound companies.

(vi) *Stock Exchange Speculation:* The joint stock company facilitates speculation in shares at stock exchanges. The reckless speculation is harmful to the interest of the share holders and for sound investment.

(vii) *Lack of Secrecy:* In a joint stock company, the management has to make an annual report, regarding sales, net profits,, assets, liabilities etc of the company. The competitors thus gain full knowledge of strong and weak points of the company. The employees also disclose the secrets of the business to rivals in the business.

(viii) *Impersonal Relationship:* As the size of business run by the company is expanding day by day, feeling of separation between the employers and the employees is widening. The company is, thus, considered soulless and cold blooded.

(ix) *Favoritism and Nepotism:* There is often a top heavy management in the company's organization. The directors, managers etc employ their near and dear ones at the key positions of the company who may or may not be f the assigned responsibilities.

(x) *Grouping for Power:* The management of the company remains in the hands of a group which acquires controlling shares. There remains tussle of grouping for power between groups.

(xi) *Evils from the Social Point of View:* The big companies become a source of encouraging monopolies. In order to secure more benefits, the influential shareholders of the company provide financial assistance to the political parties and the government officers.

Suitability of Company

A company is suitable where the volume of business is quite large, the area of operation is widespread, the risk involved is heavy and there is a need for huge financial resources and manpower. It is also preferred when there is need for professional management and flexibility of operations. In certain businesses like banking and insurance, business can only be undertaken by companies.

REVIEW QUESTIONS

Fill in the blanks:

1. A company has .... existence.
2. A company is managed by ....
3. When the area of operation of the business is .... a company form is preferred.
4. The shares of a Joint Stock Company may be .... in the stock market.

Answers: 1. perpetual 2. directors 3. wide 4. listed

STATUTORY BODIES AND CORPORATIONS

Meaning

Statutory body is a body that is created under an Act of Parliament or an Act of State Legislatures. Examples: Reserve Bank of India under the Reserve Bank of India Act, State Bank of India under a similar Act. A statutory corporation or public body is an autonomous corporate body created and set up by statute. The Act or statute defines its objectives, powers and functions. A public corporation seeks to combine the flexibility of private enterprise with public ownership and accountability. A statutory corporation does not include corporations owned by shareholders whose legal personality derives from being registered under a relevant company statute.

In the words of Roosevelt, “a public Corporation is an organisation that is clothed with the power of the government, but is possessed with the flexibility and initiative of private enterprise.”

A public corporation is thus a combination of public ownership, public accountability and business management for public end. Examples: Life Insurance Corporation of India, Employees State Insurance Corporation, Industrial

Development Bank of India. It must be remembered that, an enterprise does not become a public corporation simply by using the word 'corporation' in its name. For instance, the State Trading Corporation of India is a government company and not a public corporation.

Features

The essential features of a public corporation are as under:

(i) *Corporate Body:* It is a body corporate established through a special Act of Parliament or Stat Legislature. The Act defines its powers and privileges and its relationship with government departments and ministries.

(ii) *Legal Entity:* It enjoys a separate legal entity with perpetual succession and common seal. It can acquire an own property in its own name. It can sue and be sued and can enter into contracts in its own name.

(iii) *Government Ownership:* The public corporation is wholly owned by the Central and/ or State Government(s).

(iv) *Financial Independence:* It enjoys financial autonomy. Its initial capital and borrowings are provided by the government but it is supposed to be self-supporting. It can borrow money from the public and is empowered to plough back its earnings.

(v) *Accounting System:* The Corporation is not subject to the budgetary, accounting and audit regulations applicable to government departments. It is generally exempt from the rigid rules applicable to the expenditure of public funds.

(vi) *Management and Personnel:* A public corporation is managed by a Board of Directors appointed by the Government. However, its employees need not necessarily be civil servants. They can be employed on terms and conditions laid down by the corporation itself.

(vii) *Service Motive:* The primary motive of the corporation is public service rather than private profits. It is, however, expected to operate in a business-like manner.

Advantages of a Statutory Corporation

A Public Corporation offers the following advantages:

(i) *Operational Autonomy:* A public corporation enjoys internal autonomy as there is no Parliamentary interference in its day-to-day working. Therefore, it can be run in a business like manner. There is "a high degree of freedom, boldness and enterprise in the management of undertakings and circumspection which is considered typical of government departments".

(ii) *Flexibility Operations:* Being relatively free from bureaucratic control, a public corporation enjoys flexibility and initiative in business affairs. It can experiment in new lines of activity and decisions can be taken without undue delay.

(iii) *Continuity:* Being a distinct legal entity, it is not affected much by political changes. It can, therefore, maintain continuity of policy and operations.

(iv) *Special Privilege:* A public corporation is often granted special privileges. The special law by which by which it is created can be tailor made to meet the specific needs of the particular situation.

(v) *Availability of Managerial Talent:* A public corporation can employ professional managers by offering them better terms and conditions or service than those available to government servant.

Disadvantages of a Statutory Corporation

A public corporation suffers from the following drawbacks:

(i) *Difficult Formation:* It is very difficult and time-consuming to set up a public corporation because a special law has to be passed in the Parliament.

(ii) *Inflexibility:* It is very difficult to change the objects and powers because the special law has to be amended by the Parliament or the State legislature.

(iii) *Excessive Accountability:* There are frequent debates and discussions on the reports and working of public corporations. Ministerial and political interference in day-to-day working do not allow internal autonomy in actual practice.

(iv) *Clash of Divergent Interests:* When the Board of Directors is constituted to give representation to divergent interests, a conflict may arise. This will hamper the smooth and efficient functioning of the corporation. Emphasis on service motive and lack of incentive may further reduce the profitability of operations.

Suitability

Despite its weaknesses, the public corporation is generally considered appropriate for public enterprises of industrial and commercial nature. It represents an appropriate combination of public accountability and operational autonomy. According to Prof. Robson: “It is destined to play as important a part in the field of nationalized industry in the 20the century as the privately-owned corporation played in the realm of capitalist organisation in the 19th Century.”

The public corporation is suitable for undertakings requiring monopoly powers, e.g., public utilities. It is also useful for undertakings which involve exercise of powers to be conferred by legislature and enterprises which may not be self-supporting and have to be financed by regular grants by the State. However, in India, “it would not be wrong to say that for the most part the public corporation has lost the spirit but retained the form.” Bureaucratic management, financial dependence on the government and lack of personal motivation are the main reasons for this state of affairs.

CO-OPERATIVES, SOCIETIES AND TRUSTS

Meaning

There are certain organizations which undertake business activities with the prime objective of providing service to the members. Although some amount of profit is essential to survive in the market, their main intention is not to generate profit and grow. They pool available resources from the members, utilize the same in the best possible manner and the benefits are shared by the members.

The term co-operation is derived from the Latin word co-operari, where the word ‘co’ means ‘with’ and ‘operari’ means ‘to work’. Thus, co-operation means working together. So, those who want to work together with some common economic objective can form a society which is termed as “co-operative society”. It is a voluntary association of persons who work together to promote their economic interest. It works on the principle of self-help as well as mutual help. The main objective is to provide support to the members. Nobody joins a cooperative society to earn profit. People come forward as a group, pool their individual resources, utilise them in the best possible manner, and derive some common benefit out of it.

Any ten persons can form a co-operative society. It functions under the Cooperative Societies Act, 1912 and other State Co-operative Societies Acts.

A co-operative society is entirely different from all other forms of organization discussed above in terms of its objective. The co-operatives are formed primarily to render services to its members. Generally it also provides some service to the society. The main objectives of co-operative society are: (a) rendering service rather than earning profit, (b) mutual help instead of competition, and (c) self help in place of dependence.

Although all types of cooperative societies work on the same principle, they differ with regard to the nature of activities they perform. Followings are different types of co-operative societies that exist in our country.

(i) *Consumers' Co-operative Society:* These societies are formed to protect the interest of general consumers by making consumer goods available at a reasonable price. They buy goods directly from the producers or manufacturers and thereby eliminate the middlemen in the process of distribution. Kendriya Bhandar, Apna Bazar and Sahkari Bhandar are examples of consumers' co-operative society.

(ii) *Producers' Co-operative Society:* These societies are formed to protect the interest of small producers by making available items of their need for production like raw materials, tools and equipments, machinery, etc. Handloom societies like APPCO, Bayanika, Haryana Handloom, etc., are examples of producers' co-operative society.

(iii) *Co-operative Marketing Society:* These societies are formed by small producers and manufacturers who find it difficult to sell their products individually. The society collects the products from the individual members and takes the responsibility of selling those products in the market. Gujarat Co-operative Milk Marketing Federation that sells AMUL milk products is an example of marketing co-operative society.

(iv) *Co-operative Credit Society:* These societies are formed to provide financial support to the members. The society accepts deposits from members and grants them loans at reasonable rates of interest in times of need. Village Service Co-operative Society and Urban Cooperative Banks are examples of co-operative credit society.

(v) *Co-operative Farming Society:* These societies are formed by small farmers to work jointly and thereby enjoy the benefits of large-scale farming. Lift-irrigation cooperative societies and pani-panchayats are some of the examples of co-operative farming society.

(vi) *Housing Co-operative Society:* These societies are formed to provide residential houses to members. They purchase land, develop it and construct houses or flats and allot the same to members. Some societies also provide loans at low rate of interest to members to construct their own houses. The Employees' Housing Societies and Metropolitan Housing Co-operative Society are examples of housing co-operative society.

The following are the some of the definitions of cooperative organizations.

1. **International Labour Organisation:** "Cooperative is an association of person usually of limited means, who have voluntarily joined together to achieve a common economic, end through the formation of a democratically controlled business organisation, make equitable contribution to the capital required and accepting a fair share of risks and benefits of the undertaking."

2. **Hubert Calvest:** "Cooperative is a form of organisation wherein persons voluntary associates together as human beings on the basis of equality for the promotion of the economic interests of themselves."

3. **The Indian Cooperative Societies Act, 1912:** Section 4 of this Act defines cooperatives "as a society which has its objectives the promotion of economic interest, its members in accordance with cooperative principles. "Cooperative Society is that society which has been registered under the Cooperative Societies Act, 1912, or under any other law for the time being in force in any state registration of cooperative society."

4. **Mr. Talmaki:** "Cooperative society is an association of the weak who gather together for a common economic need and try to lift themselves from weakness into strength through business enterprise." Based on the above definitions, we can derive the following characteristics of cooperative organizations.

Characteristics

(i) *Voluntary Association:* Everybody having a common interest is free to join cooperative society. There is no restriction on the basis of caste, creed, religion, color, etc. Anybody can also leave it at any time after giving due notice to the society. That is specialty of any cooperative society. There should be minimum of 10 members to for cooperative society but there is no maximum limit for the membership.

(ii) *Separate Legal Entity:* A cooperative society after registration is recognised as separate legal entity by law. It acquires an identity quite distinct and independent of its member can purchase, dispose its own assets, can sue and also can be sued. The income of cooperative society is legally taxable as per the Income Tax Act, 1961.

(iii) *Democratic Management:* Equalities is the essence of cooperative enterprises, governed by democratic principles. Every member has got equal right over the function management of that society. As such each member has only single voting right irrespective of the number of shares held or capital contributed by them. In case of cooperative society, no member detects the terms and conditions of the functioning because "one man one vote" is the thumb rule.

(iv) *Service Motive:* The main objective being formation of any cooperative society is for mutual benefit through self-help and collective effort. Profit is not at all in the agenda of the cooperative society. But if members so like, they can take up any activities of their choice to generate surplus in order to meet the day-to-day expenses.

(v) *Utilization of Surplus:* The surplus arising from the operation of business is partly kept in a separate reserve and partly distributed as dividend among the members. According to Indian Cooperative Societies Act 1912, each society must transfer at least one-fourth of its profits to general reserve. It may distribute maximum upto 90 percent of its surplus as dividend to its members and can spent another 10 percent for the welfare of the members.

(vi) *Cash Trading:* One exception in the cooperative society is that like other business if never go for credit sales. It sells the goods on the basis of cash only. Hence, the cooperative society hardly come across with the financial hardship because of non-collection of sales dues. Members can only purchase on the basis of credit, which is an exception to the present rule.

(vii) *Fixed Rate of Return:* All members are supposed to contribute capital for the formation of a cooperative society or at the time of joining as a member of the cooperative ^society. In return to the capital invested, the members are assured of a fixed rate of return maximum to the extent of 9 per cent per annum on the sum deployed by them. This amount is being paid from the surplus generated by the society on that year. This is an incentive extended by the society to its members.

(viii) *Government Control:* All the cooperative societies of the country are regulated by the Government through its different rules and regulations framed from time to time. Cooperative societies of the country are required to register themselves as per the Indian Cooperative Societies Act, 1912. Sometimes different State Governments also frame laws regarding the registration and functioning of cooperative societies for their states.

(ix) *Capital:* The capital of the society is raised from its members by way of share capital. However, the major part of finance is raised by the society through taking loan from the Government or by accepting grants and assistance from the Central or State Government or from the apex cooperative institutions like state and central cooperative banks operating in that state.

Advantages of Co-operatives

The advantages of co-operative society are as follows:

(i) *Easy Formation:* It is very easy to form co-operative society as compared to a joint stock company. The simple requirement is ten or more members have to make written application to the Registrar with four copies of Bye-laws.

(ii) *Open Membership:* The co-operative societies work on the principle of open membership, therefore many persons can become the members. The membership is not restricted to a few persons only.

(iii) *Democratic Management:* All the members of the society are jointly known as general body, whereas the members who manage the co-operative society are jointly known as managing committee. They manage co-operative society in a democratic way. "One member one vote" is the rule and thus members can have voice in management.

(iv) *Limited Liability:* The liability of members remains limited to the extent of capital contributed by them. He is not personally liable to pay the liability of co-operative society. Generally, his liability is limited up to the face value of shares.

(v) *Stability and Continuity:* The co-operative society has perpetual succession because it is not affected due to death, insolvency or lunacy of any member. As it is voluntary association the old members may go, new members may come, but the life of society is not affected.

(vi) *Low Prices:* A co-operative society can make goods and services available at reasonable cost as the profit margin of the society is very less other reason for low price at a co-operative society is that it eliminates the middleman from chain of distribution i.e. goods are directly purchased from the manufacturers or producers and sold to the customers.

(vii) *Mutual Help:* The basic aim of the co-operative society is mutual help. Some of the members realizing this principle may offer their services on honorary basis this bring the reduction in management expenses.

(viii) *Social Advantage:* A co-operative society discourages monopoly, bring better distribution of wealth, works on principle of service and controls exploitation. It also uses its surplus profit for the social advantages by way of establishing charitable hospitals, schools, etc. So it increases social welfare.

(ix) *Mobilization of Savings:* Basically co-operative society is a thrift institution. It provides an effective means of pooling together the resources of the weaker sections of the society. By checking extravagance, it inculcates the habit of savings among the people. Such mobilized financial resources are used for constructive purposes.

(x) *Remove Defects of Capitalism:* This form of organization removes certain basic defects of capitalism. For example, monopoly, undue concentration of wealth in few hands, profiteering, black-marketing, exploitation of workers and consumers, etc. These glaring defects of capitalism have no place under co-operative organization. Through the process of integration, it removes middlemen.

(xi) *Cash Trading:* The co-operative society follows the principles of "cash and carry". As a result of this there are no bad debts and they can enjoy the benefit of various discounts and concessions. This also inculcates the habit of saving among these members.

(xii) *Government Support:* Co-operative society is basically people's movement. Moreover, promotes moral, social and educational values. It also helps the economic enlistment of the people.

Disadvantages of Co-operatives

As against the foregoing advantages, the co-operatives suffer from the following drawbacks and limitations, which prevent from securing benefits of such merits to the maximum extent:

(i) *Lack of Capital:* The co-operatives are launched by economically weaker sections of society. The shares are generally persons may associate it these societies. The resources of co-operatives are limited to the extent of capital contributed by the members and fund raising capacity from stated cooperative banks. They cannot undertake large scale production of goods for want of funds. So, co-operative societies suffer from lack of capital. It can not dream to undertake any large scale business for that reason.

(ii) *Lack of Efficient Management:* The co-operative societies, because of their limited resources, are unable to secure the services of efficient managers. They manage the society by its members who lacks managerial or professional skills. In efficient management may not bring greater success over a period of time.

(iii) *Lack of Unity among Members:* The members are drawn from different sections of the society. There may be lack of harmony among them. The members do not understand the working of the societies, so they start doubting each other. Some members lack interest in the affairs of the society and leave everything to the paid officials.

(iv) *Lack of Motivation:* Co-operation brings an end to the feeling of individual self-interest. But men are selfish by nature. Therefore, generally the members lack motivation to work more. Most of the time 'every body' responsibility becomes no bodies' responsibility.

(v) *Cash Trading:* The co-operative societies sell goods for cash and do not extend credit facilities. Many a consumers from down trodden society need credit facilities. On the other hand, private traders extend credit facilities to the consumers. Though the societies sell goods at lower prices but absence of credit facilities they prefer to avail the services of the traders for meeting their requirements.

(vi) *Political Interference:* The societies are normally under the regulations of the government. As co-operative societies stand in India, government even nominates members to the Managing Committees. Every government tries to send their own party members to these societies. The societies are governed on political consideration rather than on business lines. Political interference has badly affected co-operative movement in India.

(vii) *Difficult to Maintain Business Secrecy:* The affairs of the co-operatives are very often no such exposed to the members that it becomes difficult for them to maintain business secrecy. But secrecy is very important for success of any business.

(viii) *Unwanted Interference by the Departmental Personnel:* Co-operatives are being exposed to a considerable degree of regulation by the Co-operative department. Although to a certain degree this is welcome, too much of State participation and unwanted interference by the departmental personnel act as a deterrent to the voluntary nature of co-operatives. It adversely affecting the flexibility of its operation and the efficiency of its management.

Suitability of Co-operatives

When the purpose of business is to provide service than to earn profit and to promote common economic interest, the co-operative society is the only alternative. Co-operatives are also preferred as it is easier to raise capital through assistance from financial institutions and government. Generally it seems that a co-operative society is suitable for small and medium size operations. However, the large sized 'IFFCO' [Indian Farmers and Fertilizers Cooperative] and the Kaira Co-operative Processing Milk under the brand name 'AMUL' are the illustrious exceptions.

REVIEW QUESTIONS

1. State True or False:

(a) The members of a co-operative get a fixed rate of dividend from profit.

(b) A co-operative society can not enter into any contract without consent of all members.

2. Fill in the blanks :

(a) A co-operative society is a .... life.

(b) Membership of a co-operative is ....

(c) A co-operative's primary motive is ....

(d) The minimum membership to get a co-operative registered is ....

Answers: 1.(a) False (b) True 2. (a) Voluntary (b) Open (c) to benefit member (d) 10

LIMITED LIABILITY PARTNERSHIP

Meaning

Limited Liability Partnership entities, the world wide recognized form of business organization has been introduced in India by way of Limited Liability Partnership Act, 2008.

A Limited Liability Partnership, popularly known as LLP combines the advantages of both the Company and Partnership into a single form of organization. In an LLP one partner is not responsible or liable for another partner's misconduct or negligence; this is an important difference from that of a unlimited partnership. In an LLP, all partners have a form of limited liability for each individual's protection within the partnership, similar to that of the shareholders of a corporation. However, unlike corporate shareholders, the partners have the right to manage the business directly. An LLP also limits the personal liability of a partner for the errors, omissions, incompetence, or negligence of the LLP's employees or other agents.

Limited Liability Partnership is managed as per the LLP Agreement, however in the absence of such agreement the LLP would be governed by the framework provided in Schedule 1 of Limited Liability Partnership Act, 2008 which describes the matters relating to mutual rights and duties of partners of the LLP and of the limited liability partnership and its partners.

LLP has a separate legal entity, liable to the full extent of its assets, the liability of the partners would be limited to their agreed contribution in the LLP. Further, no partner would be liable on account of the independent or un-authorized actions of other partners, thus allowing individual partners to be shielded from joint liability created by another partner's wrongful business decisions or misconduct.

Limited Liability Partnership Act, 2008 came into effect by way of notification dated 31st March 2009.

Characteristics of LLP

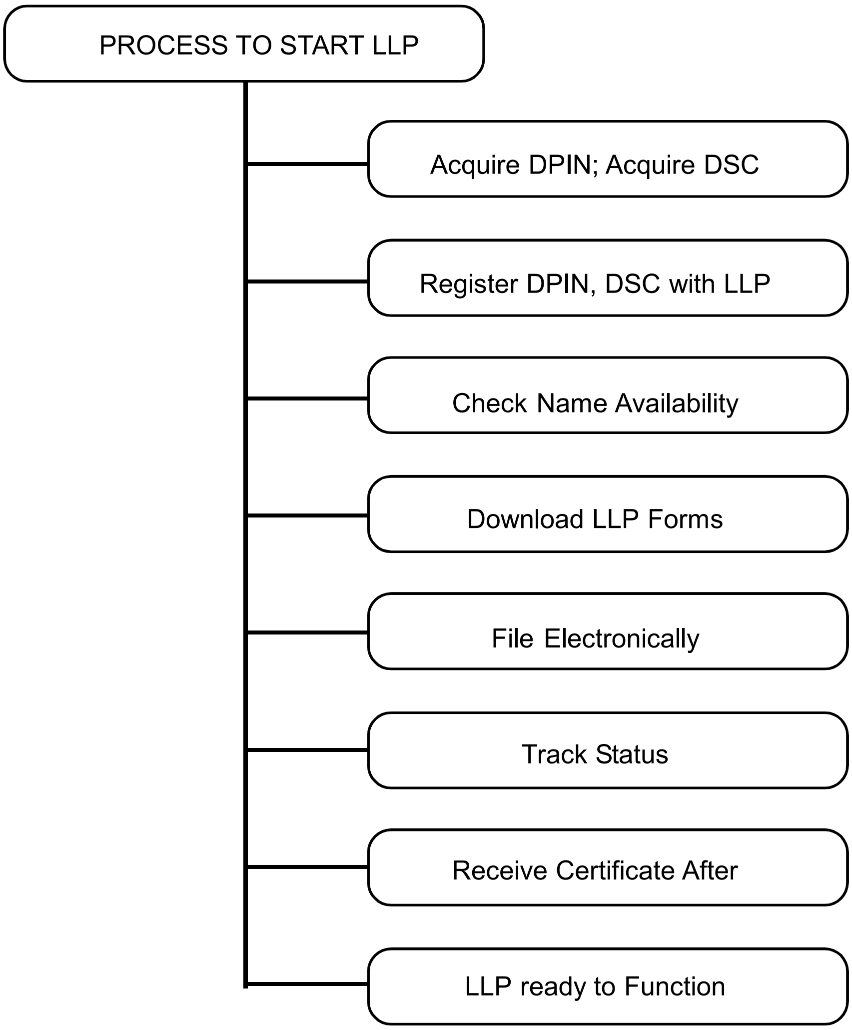
(i) The LLP shall be a body corporate and a legal entity having perpetual succession, separate from its partners.

(ii) The mutual rights and duties of partners of an LLP inter se and those of the LLP and its partners shall be governed by an agreement between partners or between the LLP and the partners subject to the provisions of the LLP Act 2008. The act provides flexibility to devise the agreement as per their choice. In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of proposed the LLP Act.

(iii) The LLP will be a separate legal entity, liable to the full extent of its assets, with the liability of the partners being limited to their agreed contribution in the LLP which may be of tangible or intangible nature or both tangible and intangible in nature. No partner would be liable on account of the independent or un-authorized actions of other partner or their misconduct. The liabilities of the LLP and partners who are found to have acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the LLP.

(iv) Every Partner Equal: Each partner is an equal member in a LLP company. They decide together on various company issues, such as the name of the business, where it is located and how it is going to be operated. Partners also share equally in the profits and losses of the business. Like a general partnership, there are no limits to the number of partners a LLP can have.

(v) Limited Liability Protection: Each partner in this type of partnership is protected against the actions of the other partners which results in a lawsuit.



Formation of LLP[1]

Advantages of LLP

– Separate legal entity

– Easy to establish

1. http://www.llp.gov.in/

– Flexibility without imposing detailed legal and procedural requirements
– Perpetual existence irrespective of changes in partners
– Internationally renowned form of business in comparison to Company
– No requirement of minimum capital contribution
– No restrictions as to maximum number of partners
– LLP & its partners are distinct from each other
– Partners are not liable for Act of other partners
– Personal assets of the partners are not exposed except in case of fraud
– Easy to dissolve or wind-up
– No requirement to maintain statutory records except Books of Accounts
– Less Cost of formation (Compared to a company)

Disadvantages of LLP

– LLP cannot raise funds from Public
– Any act of the partner without the other may bind the LLP
– Under some cases, liability may extend to personal assets of partners
– No separation of Management from owners

DIFFERENCES BETWEEN VARIOUS FORMS OF BUSINESS ORGANISATION

Sole Proprietorship and Partnership

S. No.	Basis	Sole Partnership	Partnership
1.	Membership	Only one member	Minimum membership is two; maximum membership is ten in case of banking business and twenty in other business.
2.	Functioning	A sole trader manages his business at his free will.	May be managed by all partners or any one on behalf of all others.
3.	Formation	Easy and can be formed any time as the owner decides.	An agreement is required between the partners to start a business.
4.	Secrecy	Business secrets are not open to anyone other than the proprietor	Business secrets are open to every partner.
5.	Finance	Scope for raising capital is limited	Scope for raising capital is relatively more.
6.	Continuity	Comes to an end with the death of the sole trader.	The business of a firm does of business not come to an end if a partner leaves the firm.

7.	Decision	Owner alone takes important decisions and so it is quick.	All partners must agree to decision and so decision making may take time
8.	Liability	Unlimited and the burden is heavy.	Unlimited but less burdensome as it is shared by partners.

Joint Hindu Family Business and Partnership

S. No.	Basis	Joint Hindu Family	Partnership
1.	Membership	- Members are called co-parceners - No maximum limit - Individuals become co-parceners by virtue of their birth - Women can not become co-parceners	- Members are called partners - No minor can be a full-fledged partner - Maximum membership must not exceed 10 in case of banking business and 20 in case of other business - Individuals become partners by virtue of an agreement - Women can be admitted as members
2.	Operation	Governed by Hindu Law	Governed by Indian Partnership Act
3.	Registration	Registration not required	There is a provision for registration
4.	Management	Only Karta is entitled to manage	Each partner has a right to take part in the management of the firm
5.	Profit Sharing	Every co-parcener enjoys equal share	Profit sharing ratio is decided by mutual agreement among partners
6.	Liability	Only the liability of the karta is unlimited	Every partner has unlimited liability

Partnership and Joint Stock Company

S. No.	Basis	Partnership	Joint Stock Company
1.	Formation	It is easy to form as registration is not compulsory	It requires many legal formalities to be completed before the company comes into existence.

2.	Operation	Governed by the Partnership Act, 1932	Governed by the companies Act, 2013
3.	Membership	Minimum is two; maximum is 10 in banking business and 20 in other business.	In case of Private Company minimum is 2, maximum is 200; in case of Public company minimum is 7 and maximum unlimited.
4.	Legal Status	No separate legal entity	Separate legal entity from that of its members
5.	Liability	Joint and several to an unlimited extent	Limited to the value of shares held for limited companies
6.	Management	All or any one on behalf of all partners are entitled	Only the Board of directors is authorized
7.	Transfer of shares	Consent of all partners required	Shares are freely transferable
8.	Existence	Dissolves with the death, retirement or insanity of a partner etc.	Perpetual existence, unaffected by death, retirement, insolvency of the shareholders
9.	Finance	Relatively limited scope for raising finance	Vast and unlimited scope for raising finance

Joint Stock Company and Co-operative Society

S. No.	Basis	Partnership	Joint Stock Company
1.	Formation	Comes into existence when registered with the Registrar of Co-operative Societies. There is no registration fee or stamp duty.	Comes into existence when registered with the Registrar of Companies on payment of registration fee and stamp duty.
2.	Membership	Members can be from a particular locality or a region. The minimum number of members is 2 and maximum is 100	Members are mostly from the whole country or from any other country of the world. Minimum number of members for a Private company is 2 and for Public company it is 7. The maximum membership for the former is 200 and for the latter is unlimited.
3.	Purpose	Usually to run a business and earn profit	To render services to its members in particular and to the society in general

4.	Operation	Governed by the Co-operative Societies Act and State Co-operative Societies Acts.	Governed by the Companies Act, 2013.
5.	Management	The affairs of the societies are managed by an elected by members on the basis of one member - one vote.	The affairs of the company are managed by a Board of Directors, Executive Committee elected by the shareholders. Elected member has as many votes as the number of shares held by him
6.	Transfer of Shares	Shares are not generally transferable, but Interest can be passed on to the legal heirs	Shares are freely transferable
7.	Liability	Liability of its members is generally unlimited.	Liability of its members is generally limited to the value of shares held or for the amount guaranteed by unlimited liability.
8.	Payment	A fixed rate of interest is payable and it may vary as per the provisions of the Co-operative Societies Act	The rate of dividend may change as decided by the company to its members as every year.

CHOICE OF AN APPROPRIATE FORM OF BUSINESS

A business enterprise can be owned and organized in several forms. Each form of organisation has its own merits and demerits. The ultimate choice of the form of business depends upon the balancing of the advantages and disadvantages of the various forms of business. The right choice of the form of the business is very crucial because it determines the power, control, risk and responsibility of the entrepreneur as well as the division of profits and losses. Being a long term commitment, the choice of the form of business should be made after considerable thought and deliberation

There are a number of factors to be considered while selecting an appropriate form of business organisation. Let us look into those factors one by one which are inter-related and inter-dependent as well.

(i) *Nature of Business:* The selection of a particular form of organisation is dependant upon the nature of business activity. Businesses providing direct services like tailors, restaurants and professional services like doctors, lawyers are generally organized as proprietary concerns. While, businesses requiring pooling of skills and funds like accounting firms are better organized as partnerships. Manufacturing organizations of large size are more commonly set up as private and public companies.

(ii) *Volume of Business:* If the volume of business or scale of operation is small, a sole proprietorship or partnership form is ideal. But if the volume of business is on a large scale, company form is the best. Large scale enterprises catering to national and international markets can be organized more successfully as private or public companies. Small and medium scale firms are generally set up as partnerships and proprietorship.

(iii) *Area of Operation:* Where the area of operations is wide spread (national or international), company ownership is appropriate. But if the area of operations is confined to a particular locality, partnership or proprietorship will be a more suitable choice.

(iv) *Finance:* Where the initial as well as the working capital required carrying on the business is very large, one has to opt for a company form. In other cases one can go for any other form.

(v) *Ownership and Control:* A person, who desires direct control of business, prefers proprietorship, because a company involves separation of ownership and management.

(vi) *Liability:* A person who can bear the unlimited liability of business can go for sole proprietorship or partnership form, but if he does not have the capability to shoulder the burden of unlimited liability, he may opt for either company or co-operative form.

(vii) *Independence:* The company or co-operative organizations are subject to strict government regulations. So if the entrepreneur wants to have a freedom in business with little governmental interference, he has to go for either sole proprietorship or partnership.

OTHER CORPORATION CLASSIFICATIONS

The corporation formation, normally, in one country classified it based on various factors. The factors are:

– Objectives

– Location

– Corporate Activities

– Ownership Arrangement

– Sources of Fund

Domestic and Foreign Corporations

The words for 'domestic' and 'foreign' did not meant for different in citizenship status of the business owner. It meant for different states in one country and the word for 'foreign' does not mean for international owner in the corporation.

Public and Private Corporations

A public corporation formed by the government to meet some governmental and political purposes. The very common examples are for the cities and towns benefits type of forming the corporations.

Private corporations are formed for benefits of public purposes. The word 'private' does not mean for the specific private or individual owner and it is wholly governed by the government or local government.

Non-profits Corporation

Common examples for nonprofit corporations are educational, charitable, religious, and community care corporations. It is a total not-to-profit type of corporation and operating with different policies under state governance although it is owned by private. It can issue shares of stock but not for dividend disbursement.

Professional Corporations

This type of corporation mostly a professional corporation includes the professional practitioners by profession e.g. medicine, accountant, law, etc. It is much better than partnership form of organization because of its tax benefits which provides medical benefits, pension plan, and so forth.

LESSON ROUND UP

- Business organizations are units that undertake industrial and commercial activities with the objective of making profits.
- The entrepreneur, while selecting a form of organization for his business, should select suitable form of commercial organization which depends upon the following factors:
  - Ease of Formation
  - Adequacy of Capital
  - Limit of Liability
  - Relationship between Ownership, Control and Management
  - Continuity and Stability
  - Flexibility of Operations
  - Distinct Ownership
  - Lawful Business
  - Separate Status and Management
  - Dealing in Goods and Services
  - Continuity of Business Operations
  - Risk Involvement
- Forms of business organization are legal forms in which a business enterprise may be organized and operated. These forms of organization are :
  - Sole Proprietorship
  - Hindu Undivided Family Business
  - Partnership
  - Company
  - Statutory Bodies and Corporations
  - Co-Operatives, Societies and Trusts
  - Limited Liability Partnership

GLOSSARY

Sole Proprietorship A business structure in which an individual and his/her company are considered a single entity for tax and liability purposes. A sole proprietorship is a company which is not registered with the state as a limited liability company or corporation. The owner does not pay income tax separately for the company, but he/she reports business income or losses on his/her individual income tax return. The owner is inseparable from the sole proprietorship, so he/she is liable for any business debts also called proprietorship.

Hindu Undivided Family Business	A Hindu Joint Family or Hindu undivided family (HUF) or a Joint Family is an extended family arrangement prevalent among Hindus of the Indian subcontinent, consisting of many generations living under the same roof. All the male members are blood relatives and all the women are either mothers, wives, unmarried daughters, or widowed relatives, all bound by the common relationship.
Partnership	A type of unincorporated business organization in which multiple individuals, called general partners, manage the business and are equally liable for its debts; other individuals called limited partners may invest but not be directly involved in management and are liable only to the extent of their investments.
Company	An association of persons for the purpose of carrying on business. Any entity engaging in business or corporation registered under Companies Act, 2013.
Statutory Bodies and Corporations	A statutory corporation is a corporation created by statute. Their precise nature varies by jurisdiction thus they might be ordinary companies/corporations owned by a government with or without other shareholders, or they might be a body without shareholders which is controlled by national or sub-national government to the extent provided for in the creating legislation.
Limited Liability Partnership	A form of partnership where the partner or investor's liability is limited to the amount nvested in the company.

SELF-TEST QUESTIONS

1. Discuss the features of an ideal form of business ownership?
2. Explain various factors that an entrepreneur should keep in consideration before selecting a suitable form of business organization.
3. How are other corporations classified?
4. Distinguish between
   (i) Sole prorietorship and Partnership
   (ii) Partnership and Company
   (iii) Company and Statutory Bodies
   (iv) Partnership and Limited Liability Partnership
   (v) Company and Limited Liability Partnership.

Lesson 3
Scales of Business

LESSON OUTLINE

- Introduction
- Micro Enterprises
- Small Scale Enterprises
  - Role of Small Scale Industries
- Large Scale Enterprises
  - Organisation of Public Enterprises
- Public Enterprises
  - Current Scenario
- Review Questions
- MNCs
- Why the drive to MNCs?
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

People engaged in business undertake their activities regularly and thereby earn profit. Although, all these businesses have a common objective of earning profit, they differ from each other with respect to their size, nature, volume of transaction, management and ownership, etc. Thus, structurally they are different. Broadly business may be classified on basis of size, functions and ownership.

But, when we talk about Scales of business, we in a nutshell refer to size of the business. Micro and small is well, small; a store or shop or self employed business. Large, on the other hand, would be business with wide coverage. MNCs, therefore have a coverage beyond one nation. It is a global concept.

The world is integrating into one unit with technological progress and new inventions like internet,etc. making even small firms to operate over a wider geographical area.

In this context, this lesson will enable us to understand differrent scales of business.

The good business leaders create a vision, articulate the vision, passionately own the vision, and relentlessly drive it to completion.

Jack Welch quotes

INTRODUCTION

Business ranges in size from the single proprietor at one extreme to the large multinational at the other which employs thousands of people over several countries. The structure of these businesses will be very different and the problems they face will vary as a result of the differences in size. The size structure of business will depend on many factors range from choice to external factors which are beyond the control of the firm.

According to the Micro, small and medium enterprise development Act 2005, 'enterprise' means an industrial undertaking or a business concern or any other establishment, by whatever name called, engaged in the manufacture or production of goods, in any manner, pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 or engaged in providing or rendering of any service or services. Enterprises may be classified based on various categories; for instance type of industry or size of the industry, choice of business activity etc.

The classification of enterprises based on scale of business is as under:

MICRO ENTERPRISES

In developing countries, micro enterprises comprise the vast majority of the small business sector—a result of the relative lack of formal sector jobs available for the poor. These micro entrepreneurs operate not by choice, but out of necessity. Micro enterprises add value to a country's economy by creating jobs, enhancing income, strengthening purchasing power, lowering costs and adding business convenience. In case of developing countries, the majority of the population is engaged in producing non monetary wealth primarily for self consumption rather than for sale. The vast majority of agricultural wealth is subsistence production. It is not produced for cash or for barter, and is not available to be used by the economy of the nation as a whole. By the laws of supply and demand, then, there is a deficit of products resulting from initial processing of agricultural products (they are in short supply and their prices are too high). The sector which is most encouraged in low income countries, because it shows the most promise for sustainable development, is potentially most viable for micro entrepreneurs, and fills the most necessary niche in the economy, is the initial processing of agricultural products.

Families launch enterprises to generate income, built savings and to acquire assets as a cushion against natural disasters, illness or death, and other crisis. Because micro enterprises typically have little to no access to the commercial banking sector, they often rely on "micro-loans" or micro credit in order to be financed. Microfinance institutions often finance these small loans, particularly in the Third World. Those who found micro enterprises are usually referred to as entrepreneurs. Micro-enterprise provides most of the goods and services that meet people's basic needs in developing and redeveloping countries. Micro enterprises in developing countries, tend to be the most frequent form/size of business. Micro enterprises require small amounts of capital to enter to the market and produce quickly. The small size of micro enterprise makes them simple to operate. Micro enterprise use local product and skills. Micro enterprises are labour intensive therefore create jobs. Micro enterprises are a catalyst for comprehensive community development.

The Central Government has classified in the case of the enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the Industries (Development and Regulation) Act, 1951, as a micro enterprise, where the investment in plant and machinery does not exceed twenty five lakh rupees; in the case of the enterprises engaged in providing or rendering of services, as a micro enterprise, where the investment in equipment does not exceed ten lakhs rupees.

SMALL SCALE ENTERPRISES

Meaning and Concept of Small Scale Industry

In most of the developing countries including India, Small Scale Industries (SSI) constitutes an important and crucial segment of the industrial sector. They play an important role in employment creation, resource utilisation and income generation and helping to promote changes in a gradual and phased manner. They have been given an important place in the framework of Industrial planning both for economic and ideological reasons.

The scarcity of capital in developing nations severely limits the number of non-farm jobs that can be created because investment costs per job are high in large and medium industries. An effective development policy has to attempt to increase the use of labour, relative to capital to the extent that it is economically efficient.

Small scale enterprises are generally more labour intensive than larger organisations. As a matter of fact, small scale sector has now emerged as a dynamic and vibrant sector for the Indian economy in recent years. It has attracted so much attention not only from industrial planners and economists but also from sociologists, administrators and politicians.

Definition of Small Scale Industry (SSI)

Basically, the industries which are organized on a small scale and produce goods with the help of small machines, hired labour and power are called as small scale industries

The definition for small-scale industrial undertakings has changed over time. Initially, they were classified into two categories- those using power with less than 50 employees and those not using power with the employee strength being more than 50 but less than 100. However, the capital resources invested on plant and machinery buildings have been the primary criteria to differentiate the small-scale industries from the large and medium scale industries.

An industrial unit can be categorized as a small- scale unit if it fulfils the capital investment limit fixed by the Government of India for the small-scale sector. The Central Government has classified in the case of the enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the Industries (Development and Regulation) Act, 1951, a small enterprise, where the investment in plant and machinery is more than twenty five lace rupees but does not exceed five crores rupees; in the case of the enterprises engaged in providing or rendering of services, a small enterprise, where the investment in equipment is more than ten lace rupees but does not exceed two crores rupees.

Classification of Small Scale Industry

A common classification is between traditional small industries and modern small industries. Traditional small industries include khadi and handloom, village industries, handicrafts, sericulture, coir, etc. Modern SSIs produce wide range of goods from comparatively simple items t sophisticated products such as television sets, electronics, control system, various engineering products, particularly as ancillaries to the large industries. The traditional small industries are highly labour-intensive while the modern small-scale units make the use of highly sophisticated machinery and equipment.

I. Registered SSI sector

– All the SSI units permanently registered up to 31-3-2001 numbering 22,62,401 were surveyed on complete enumeration basis, of which 13,74,974 units (61 %) were found to be working and 8,87,427 units (39 %) were found to be closed.

– Of the 13,74,974 working units, 9,01,291 were SSIs and 4,73,683 were SSSBEs. Thus, the proportion of SSIs was 65.55 %. About 5.08 % of the SSI units were ancillary units. The proportion of the units operating in rural areas was 44.33 %.

- In terms of no. of working units, six States, viz., Tamil Nadu (13.09 %), Uttar Pradesh (11.85 %), Kerala (10.69 %), Gujarat (10.08 %), Karnataka (8.04 %) and Madhya Pradesh (7.41 %) had a share of 61.16 %.
- With regard to closed units, six States, viz., Tamil Nadu (14.33 %), Uttar Pradesh (13.78 %), Punjab (9.32 %), Kerala (8.43 %), Madhya Pradesh (7.4 %) and Maharashtra (6.11 %) had a share of 59.37 %.
- The per unit employment was 4.48. The employment per Rs. one lakh investment in fixed assets was 0.67.
- Rice milling industry topped the list in terms of gross output. In terms of exports, textile garments and clothing accessories industry was on top.
- Compared to Second Census, the Third Census brought out some structural changes in the registered SSI sector. While the proportion of working units remained the same by and large, the domination of SSIs among the working units has been reduced considerably from 96 % to 66 %. This is mainly due to the increase in the number of units engaged in services. The per unit employment has gone down from 6.29 to 4.48. The per unit fixed investment has gone up from Rs.1.60 lakhs to 6.68 lakhs. This could be due to technological upgradation.

II. Unregistered SSI sector

- This sector was surveyed using a two-stage stratified sampling design. Out of the 9,94,357 villages and urban blocks, 19,579 villages and urban blocks were surveyed to identify the units of unregistered SSI sector. Out of these, information was completely received in respect of 19,278 villages and urban blocks. In these villages and urban blocks, the enumerators selected 1,68,665 unregistered SSI units for survey, but they could actually survey 1,67,665 units.
- The size of the unregistered SSI sector is estimated to be 91,46,216. Of these, only 38.75 % were SSIs and the rest were SSSBEs.
- The reasons for non-registration were elicited in the Third Census. Interestingly, 53.13 % of the units informed that they were not aware of the provision for registration, while 39.86 % of the units indicated that they were not interested.
- About 45.38 % of the units were engaged in Services while 36.12 % were engaged in manufacturing and the rest of the 18.5 % in repair/ maintenance.
- Maximum number of unregistered SSI units (16.89 %) were located in Uttar Pradesh. The other States having very high concentration of unregistered SSI units were Andhra Pradesh, West Bengal, Maharashtra, Madhya Pradesh, Tamil Nadu, Karnataka, Bihar, Rajasthan and Gujarat.
- 96.9 % of the units were proprietary units and about 1.13 % of the units were partnership units.
- The average employment was 2.05 and the employment generated per one lakh fixed investment was 3 persons.
- About 10.13 % of the units were women enterprises and 57 % of the units were managed by socially backward classes.

III. Total SSI sector

- The size of the total SSI sector is estimated to be over one crore (1,05,21,190). About 42.26 % of these units were SSIs and the rest were SSSBEs. The number of ancillaries among SSIs were 2.98 %.
- About 47.22 % of the units were located in Uttar Pradesh, Andhra Pradesh, Maharashtra, Madhya Pradesh and Tamil Nadu.
- The Services Sector emerged as the dominant component in the Total SSI Sector with a share of 44 % of the units.
- Although registration is voluntary in the SSI sector, the registered SSI sector was found to be the cream of

the Total SSI sector. In terms of size, it was only 13 %, but in terms of investment its share was 59 % and it contributed to 59 % of the total production.

- About 95.8 % of the units were of proprietary type of ownership. Entrepreneurs belonging to socially backward classes managed about 56 % of the units.
- The number of women enterprises was 10.11 %. The number of enterprises actually managed by women was 9.46 %.
- The number of women employees was of the order of 13.31 %. The employees belonging to socially backward classes numbered 57.45 %.

IV. Sickness in SSI sector

- Sickness was identified through the latest definition of RBI given by Kohli committee and incipient sickness was identified in terms of continuous decline in gross output.
- Sickness in the Total SSI sector was of the order of 1 %, whereas in the registered and unregistered SSI sectors it was 3.38 % and 0.64 % respectively.
- The maximum number of sick units were located in West Bengal, Kerala, Maharashtra, Karnataka and Andhra Pradesh. About 59.53 % of the sick units were located in these five States.
- Out of the units having loan outstanding with institutional sources like banks and financial institutions, sickness was about 19.6 % in the registered SSI sector and 16.61 % in the case of unregistered SSI sector. In the Total SSI sector, this percentage was 17.8.
- Incipient sickness identified in terms of continuous decline in gross output was 11.5 % in the registered SSI sector and 6.48 % in the unregistered SSI sector. In the Total SSI sector, this percentage was 7.4.
- Combining the three yardsticks used to measure sickness, viz., (a) delay in repayment of loan over one year, (b) decline in net worth by 50 %, and (c) decline in output in last three years, about 13.98 % of the units in the registered SSI sector were identified to be either sick or incipient sick, while this percentage was only 6.89 in the case of unregistered units. In the Total SSI sector, this percentage was 7.82.
- The States of Kerala, Tamil Nadu, Andhra Pradesh, Karnataka, and Maharashtra had maximum number of sick/ incipiently sick SSI units. These five States together accounted for 54.28 % of the sick/ incipiently sick SSI units in the country.
- 'Lack of demand' and 'Shortage of working capital' were the main reasons for sickness/ incipient sickness in both the registered and unregistered SSI sectors.

Role of Small Scale Industries in the Indian Economy

The small-scale industrial sector plays a pivotal role in the Indian economy in terms of employment and growth has recorded a high rate of growth since Independence in spite of stiff competition from large-scale industries. There are several important reasons why these industries are contributing a lot to the progress of Indian economy;

(i) *Production:* The small-scale industries sector plays a vital role in the growth of the country. It contributes almost 40% of the gross industrial value added in the Indian economy. It has been estimated that a million Rs. of investment in fixed assets in the small scale sector produces 4.62 million worth of goods or services with an approximate value addition of ten percentage points. The small-scale sector has grown rapidly over the years. The growth rates during the various plan periods have been very impressive. The number of small-scale units has increased from an estimated 0.87 million units in the year 1980-81 to over 3 million in the year 2000.When the performance of this sector is viewed against the growth in the manufacturing and the industry sector as a whole, it instills confidence in the resilience of the small scale sector.

(ii) *Employment:* SSI Sector in India creates largest employment opportunities for the Indian population, next only to Agriculture. It has been estimated that 100,000 rupees of investment infixed assets in the small-scale sector generates employment for four persons.

(iii) *Export:* SI Sector plays a major role in India's present export performance. SSI Sector contributes 45%-50% of the Indian Exports. Direct exports from the SSI Sector account for nearly 35% of total exports. Besides direct exports, it is estimated that small-scale industrial units contribute around 15% to exports indirectly. This takes place through merchant exporters, trading houses and export houses. They may also be in form of export orders from large units or the production of parts and components for use for finished exportable goods.

(iv) *Opportunity:* The opportunities in the small-scale sector are enormous due to the following factors:

– Less Capital Intensive

– Extensive Promotion & Support by Government

– Reservation for Exclusive Manufacture by small scale sector

– Project Profiles

– Funding - Finance & Subsidies

– Machinery Procurement

– Raw Material Procurement

– Manpower Training

– Technical & Managerial skills

– Tooling & Testing support

– Reservation for Exclusive Purchase by Government

– Export promotion

– Growth in demand in the domestic market size due to overall economic growth

(v) *Increasing Export Potential for Indian Products:* Growth in Requirements for ancillary units due to the increase in number of green field units coming up in the large-scale sector. Small industry sector has performed exceedingly well and enabled our country to achieve a wide measure of industrial growth and diversification

– Fashion technology

– Information technology

– Design technology

(vi) *Welfare:* These industries are also very important for welfare reasons. People of small means can organize these industries. This in turn increases their income levels and quality of life. As such these can help in reducing poverty in the country. Further, these industries tend to promote equitable distribution of income. The reasons are obvious. One, a large proportion of income generated in these enterprises is distributed among the workers. Two, income are distributed among a vast number of persons throughout the country. All these benefits flow from the fact that these industries are highly labour-intensive, and that these can be set up anywhere in the country. Distributive aspect of small-scale industries further unravels their two-fold beneficial character. On the one hand, these industries enable a vast number of people to earn income and on the other hand the very people among whom these are distributed generate this income.

LARGE SCALE ENTERPRISES

Large scale industries refers to those industries which require huge infrastructure, man power and a have influx of capital assets. The term ‘large scale industries’ is a generic one including various types of industries in its purview. All the heavy industries of India like the Iron and steel industry, textile industry, automobile manufacturing industry fall under the large scale industrial arena. However in recent years due to the IT boom and the huge amount of revenue generated by it the IT industry can also be included within the jurisdiction of the large scale industrial sector. Last but not the least, the telecoms industry also forms and indispensable component of the large scale industrial sector of India. Indian economy is heavily dependent on these large industries for its economic growth, generation of foreign currency and for providing job opportunities to millions of Indians.

In India, industries with a fixed asset of more than one hundred million rupees are called large scale industries. These could be manufacturing units or others which use both indigenous and imported technologies. They cater to both the local and foreign markets. Examples of large scale industries include fertilizer, cement, natural gas, coal, metal extraction, metal processing, petroleum, natural gas, mining, electrical, petrochemical, food processing units, tourism, banking, sugar, construction, automobile, communication equipment, cement, chemicals, earth movers, consumer durables (like television, refrigerators, etc), engineering products, vehicle assembly, beverages, gas and water; other fuels, agricultural processing, insurance and finance. With the opening up of the market and globalization, the effects on such industries has been mixed, some have gained by attracting foreign customers, foreign trade and technology, tie-ups, while others have lost out due to their inability to cope up with the open market competition.

PUBLIC ENTERPRISES

Traditionally, business activities were left mainly to individual and private organisations, and the government was taking care of only the essential services such as railways, electricity supply, postal services etc. But, it was observed that private sector did not take interest in areas where the gestation period was long, investment was heavy and the profit margin was low; such as machine building, infrastructure, oil exploration etc. not only that, industries were also concentrated on some regions that had certain natural advantages like availability of raw material, skilled labour and nearness to market. This led to regional imbalances. Hence while government regulating the business activities of private enterprises went in for direct participation in business and set up public enterprises in areas like coal industry, oil industry, machine building, steel manufacturing, finance and banking, insurance etc. These units are not only owned by central, State or local government but also managed and controlled by them and are termed as Public Sector Enterprises.

Meaning of Public Enterprises

Public enterprises as a form of business organisation have attained a great deal of significance in recent times. During 20th century various governments have taken active part in the industrial and commercial activities. The term public enterprise denotes a form of business organisation owned and managed by the state government or any other public authority. So it is an undertaking owned and controlled by the local or state or central government. The whole or most of the investment is made by the government.

According to A. H. Hansen, a public enterprise denotes "state ownership and operation of industrial, agricultural, financial and commercial undertakings". According to N. N. Malaya, "Public enterprises are autonomous or semi-autonomous corporations and companies established, owned and controlled by the state and engaged in industrial and commercial undertakings".

A public sector enterprise may be defined as any commercial or industrial undertaking owned and managed by the government with a view to maximise social welfare and uphold the public interest.

Public sector consists of nationalised private sector enterprises, such as, Insurance, Banks and new undertaking set up by the government such as Hindustan Machine Tools (HMT), Gas Authority of India (GAIL) etc.

Characteristics of Public Enterprises

The chief characteristics of public enterprises are:

(i) *Autonomous or Semi-Autonomous Organisation:* Public enterprise is an autonomous or semi-autonomous organisation because some enterprises work under the direct control of the government and some organizations are established under statutes and companies act.

(ii) *State Control:* The public enterprises are financed, owned and managed by the government may be a central or state government.

(iii) *Rendering Service:* The primary objective of the establishment of public enterprises is to serve the public at large by supplying the essential goods at a reasonable price and creating employment opportunities.

(iv) *Useful to Various Sectors:* The state enterprises serve all sectors of the people of the company. They do not serve a particular section of the people in the community.

(v) *Monopoly Enterprises:* In some specific cases private sectors are not allowed and as such the public enterprises enjoy monopoly in operation. The state enterprises enjoy monopoly in Railways, Post and Telegraph and Energy production.

(vi) *A Direct Channel for Use of Foreign Money:* Sometimes the government receives foreign assistance from industrially advanced countries for the development of industries. These advances received are spent through public enterprises.

(vii) *Public Accountability:* The state enterprises are liable to the general public for their performances because they are responsible for the nation.

(viii) *Agent for Implementing Government Plans:* The public enterprises run as per the whims of the government and as such the economic policies and plans of the government are implemented through public enterprises.

(ix) *Financial Independence:* Though investment in government undertaking is done by the government, they become financially independent by arranging finance for day-to-day operation.

Organisation of Public Enterprises

There are three different forms of organisation used for the public sector enterprises in India.

– Departmental Undertaking

– Statutory (or Public) Corporation

– Government Company

Departmental Undertaking form of organisation is primarily used for provision of essential services such as railways, postal services, broadcasting etc. Such organisations function under the overall control of a ministry of the Government and are financed and controlled in the same way as any other government department. This form is considered suitable for activities where the government desires to have control over them in view of the public interest.

Statutory Corporation (or Public Corporation) refers to a corporate body created by the Parliament or State Legislature by a special Act which defines its powers, functions and pattern of management. Statutory Corporation is also known as Public Corporation. Its capital is wholly provided by the government. Examples of such organisations are Life Insurance Corporation of India, State Trading Corporation etc.

Government Company refers to the company in which 51 percent or more of the paid up capital is held by the government. It is registered under the Companies Act and is fully governed by the provisions of the Act. Most business units owned and managed by government fall in this category.

Types	Department Undertakings	Statutory Corporations	Government Companies
Meaning	These enterprises are directly managed by different departments of Government	These enterprises are established by special Acts of the parliament or state assembly	These enterprises are registered as Joint Stock Companies under the Indian Companies Act, 2013. The management and control of these companies also lie with the Government. Majority of share capital of these companies are held by the central/state government.
Example	Indian Railways, Posts and telegraph	Unit Trust of India, Life Insurance Corporation of India, Food Corporation of India	Bharat Heavy Electricals Limited, Bharat Electronics Limited, Hindustan Machine Tools Limited

Development of Public Enterprises in India

Public sector enterprises occupy an important place in the Indian economy. When India became independent in 1947, we hardly had any public enterprises. In fact, we had only three departmental enterprises, one, dealing with the railways, one dealing with the post and telegraphs, and the third dealing with defense production. The British ensured that defense production would remain a closely guarded secret and would be kept within the state. The railways, as you know, helped in large scale extraction of resources, and so it was important and had to be run with the help of the state, and of course the post and telegraph department which was important for its own functional and strategic reasons.

The foundations of the strong public enterprises, particularly the goods producing sectors in the Indian economy was firmly laid by our first Prime Minister Jawahar Lal Nehru who was also inspired and supported by the Josip Broz Tito and Abdel Gamal Nasser. These three renowned statesmen were not only the architects of the Non Aligned Movement but also farsighted leaders who laid strong foundations for the public sector in their countries, the public sector that we are proud of today, and which has benefited the Indian economy in a very sustainable way. When we started building an independent nation in 1951, we had only five public enterprises with a total investment of less than half a billion euros. Today, the number of CPSUs has increased spectacularly to 247 enterprises with a total investment of about 130 billion euros. At the commencement of the first five-year plan (1.4.1951) Government's investment was ₹29 crores in five central public sector enterprises. Now it has increased to ₹3,93,057 crores in 239 enterprises as on 31 March 2006. The public sector enterprises have been making substantial contribution to augment the resource of central government. During 2004-05 their contribution to the central exchequer was ₹1,10,599 crores.

Public enterprises in India have been, perhaps, the most important strategic component of the Indian economy. They have over the years enabled balanced regional investment that is a very important concern for such a big country as India. There are many regions in India where the private sector requires a very high level of incentives and other 'concessions' in order to be induced to operate. The public sector has taken up these challenges and has taken the lead in bringing about balanced regional growth and development of industry in different parts of country. They have also contributed significantly by generating large surpluses, giving the state the ability to be able to finance large developmental programmes in the country.

They provide greater economy in functioning due to unified controls, and also enjoy tremendous economies of scale. Public sector enterprises have also had a very significant impact on the Indian consumer. They have protected and benefited consumers in a very big way. They have also provided a fair deal to workers as compared to the private sector in India. They have also always taken the lead to initiate development in the core sector that we define as those strategic sectors which complement and provide externalities to the economy as a whole and to other industries in the private sector. They have never hesitated to venture into the core sector where on a purely commercial criterion the returns are known to be modest or at times quite insignificant. PSEs accounts for 20 % of our gross national product. A fairly, large proportion of the gross national product is saved. The total savings rate in PSEs is 35%, and nearly 4% of total national savings is contributed by PSEs. PSE also significantly contributes through dividends paid to the government and also towards enhancing export earnings and import substitution. In terms of employment, in a country of a population in excess of a billion, the contribution of PSEs has been substantial. It currently employs 1.9 million persons while the Indian private sector employs about 0.9 million persons, so it is a major employer.

There is no doubt that public enterprises have played a significant role in the Indian economy. But the overall performance of most of the public sector enterprises is not satisfactory. The rate of return on capital investment is very low.

To improve the performance of the public enterprise, Government of India has taken several measures. On 24 July 1991 the Government of India announced its Industrial policy to improve the performance and portfolio of public sector enterprises. The new economic policies also emphasised on liberalisation, privatisation and globalisation of Indian economy. The role of public sector was redefined. In July 1997, Government identified nine central public sector enterprises as ‘Navaratnas’. They are BHEL, BPCL, GAIL, HPCL, IOC, MTNL, NTPC, ONGC, and SAIL. These public sector enterprises have been given autonomy for capital investment, to enter into joint ventures, to raise capital from domestic and international market etc. In October 1997, the Government granted enhanced autonomy and delegation of financial power to some other profit making public sector enterprises and categorised them as ‘Miniratna’. Presently there are 45 Miniratna Public Sector Enterprises functioning in India.

The Government has taken every step to revive and restructure the public sector enterprises to improve their performance, productivity and profitability. Major emphasis has been laid on the sick and chronically loss making enterprises, which are capable of being revived. These enterprises are referred to Board for Industrial and Financial Reconstruction (BIFR) to prepare appropriate revival or rehabilitation package. The government has set up a Board for Reconstruction of Public Sector Enterprises (BRPSE), which considers and advises the Government on the proposal of restructuring/ revival of sick and loss making units including the proposal for disinvestment or closure or sale. BRPSE has made recommendations in respect of 31 central public sector enterprises so far and out of them the Government has approved revival plan of 15 cases till 30 March 2006.

BHEL achieved a turnover of Rs.21,401 crore during 2007-2008 which was a growth of 14% over the production of Rs. 18739 crore in 2006-07. Over and above the orders of Rs.50,000 crore received in 2007-08, BHEL made substantial additions to its order book during current financial year bagging orders worth Rs. 44000 crore up to December, 2008. BHEL and NTPC Limited incorporated a Joint Venture Company (JVC) called “NTPC-BHEL Power Projects Pvt. Ltd.,” to execute Engineering, Procurement and Construction (EPC) contracts for Power Plants and other Infrastructure Projects as well as manufacture and supply of equipment in India and abroad. CMDs of BHEL signed a Memorandum of Understanding with APGENCO for setting up the Nation’s Biggest Integrated Coal Gasification Combined Cycle (IGCC) Power Plant of 125 MW at Vijayawada on 10.5.2008.

Performance of Industry

The industrial performance is measured in terms of Index of Industrial Production (IIP). IIP registered a growth of 1.2% in the first seven month of the current year (April - October) 2012-13 against 3.6% in the corresponding period of year (2011-12). Manufacturing sector recorded a growth of 1.0% in (April-October) 2012-13 against 3.8% in the corresponding period of year (2011-12).

The mining and electricity sector posted growth rates of (-)0.7% and 4.7% respectively during (April - October) 2012-13 compared to (-) 2.2% and 8.9% registered during the corresponding period year 2011-12.

Capital goods sector has registered a growth of (-) 11.4% during (April - October) 2012-13 as compared to the growth of (-) 0.5% during corresponding period of year (2011-12).

Consumer goods recorded a growth of 4.0%, 3.0% and 2.3% respectively during (April - October) 2012-13. The consumer durable sector recorded a growth of 5.6% in (April - October) 2012-13 as compared to 4.5% in corresponding period of the previous year.

In the 12th five year plan (2012-17) the following schemes have been taken up in the department of public enterprises:

1. National Automotive Testing and R&D Infrastructure Project (NATRIP).

2. Restructuring of PSEs under DHI/FCRI and schemes towards promotional measures, modernization of offices, IT, etc.

3. Jagdishpur, U.P. paper mill project of Hindustan Paper Corporation Ltd. (HPC).

4. Scheme for Enhancement of Competitiveness in Capital Goods Industry.

5. Schemes for North Eastern Region (HPC, NPPC, CCI & AYCL).

REVIEW QUESTIONS

Fill in the Blanks:

1. Public sector has three forms of organisation ...., statutory and ....

State True or False:

2. Micro and Small Entrerprises are same.

Answers: 1. Departmental, Government Company 2. False

MULTINATIONAL CORPORATIONS (MNCs)

Multinational corporations (MNCs) are key agents transforming the international political and economic landscape. Because they are highly visible organizations with great power and mobility, they inspire both awe and fear. A Multinational Corporation (MNC) or Multinational Enterprise (MNE) is a corporation enterprise that manages production or delivers services in more than one country. The International Labour Organization (ILO) has defined an MNC as a corporation that has its management headquarters in one country, known as the home country, and operates in several other countries, known as host countries.

Thus a multi-national corporation (MNC) is a business organisation which has its headquarters in one country but has operations in a range of different countries. There are numerous examples of such organisations, car manufacturers like Ford, Toyota, Honda and Volkswagen, oil companies like Shell, BP and Exxon Mobil, technology companies like Dell, Microsoft, Hewlett Packard and Canon and food and drink companies such as Coca Cola, Interbrew and McDonalds.

Multinational corporations (MNCs) are huge industrial organizations having a wide network of branches and subsidiaries spread over a number of countries. The two main characteristics of MNCs are their large size and the fact that their worldwide activities are centrally controlled by the parent companies. Such a company may enter into joint venture with a company in another country. There may be agreement among companies of different countries in respect of division of production, market, etc. These companies are to be found in almost all the advanced countries, with the USA perhaps the biggest amongst them. Their operations extend beyond their own countries, and cover not only the advanced countries but also the LDCs.

Many MNCs have annual sales volume in excess of the entire GNPs of the developing countries in which they operate. MNCs have great impact on the development process of the Underdeveloped countries.Typically, MNCs go overseas because they possess some special advantage they want to exploit fully and because there are benefits to locating their activities abroad. These benefits may range from avoiding barriers to imports to employing cheaper, foreign labor. The exact model for an MNC may vary slightly. One common model is for the multinational corporation is the positioning of the executive headquarters in one nation, while production facilities are located in one or more other countries. This model often allows the company to take advantage of benefits of incorporating in a given locality, while also being able to produce goods and services in areas where the cost of production is lower. Another structural model for a multinational organization or MNO is to base the parent company in one nation and operate subsidiaries in other countries around the world. With this model, just about all the functions of the parent are based in the country of origin. The subsidiaries more or less function independently, outside of a few basic ties to the parent.

A third approach to the setup of an MNC involves the establishment of a headquarters in one country that oversees a diverse conglomeration that stretches to many different countries and industries. With this model, the MNC includes affiliates, subsidiaries and possibly even some facilities that report directly to the headquarters. In a world that continues to become more interconnected each day, a multinational corporation sometimes has a greater ability to adapt to economic and political shifts those corporations that function in a single nation. Along with decreasing costs associated with producing core products, this business model also opens the door for diversification, which often makes it possible for a company to remain solvent even when one division or subsidiary is posting a temporary loss.

Why the drive for MNCs?

For many companies, the following might be some or all of the reasons to expand into different countries:

- Reduce transport and distribution costs
- Avoid trade barriers
- Meet different rules and regulations (avoid non-tariff barriers)
- Secure supplies of raw materials or markets
- Cost advantages - for example low labour costs
- The advantages of MNCs
- Economic Growth and Employment

The essence of a MNC is that they bring inward investment to countries that are not their home base. If they choose to expand by building production facilities they will be bringing in inward investment into the country. This investment is likely to provide a boost, not only to the local economy but also the national economy.

Building a new plant requires resources - land, labour and capital. Labour has to be found to help construct the plant and all the equipment that goes into it and some firm somewhere will be hired to build the machinery and equipment, provide the bricks, steel, cement, glass etc. that go into the building. If it is announced that Company X from Germany are to build a new distribution centre in the UK at a cost of £10 million, this effectively means that a whole host of firms will be getting additional work to the value of £10 million.

Let us assume that a firm manufactures and supplies cable for electrical work. To this firm, the contract to supply the cabling for the new plant might be worth £350,000. If the plant was not built then the firm would not generate that order and not receive that work. For workers in the cabling plant, the order helps to maintain the flow of orders and can keep them in employment.

It can also be expected that the additional income will find its way through the local economy. If additional people are hired, they will receive an income which they spend. For existing workers, increased orders might equate to job security and they too might feel more confident in spending on new items - furniture, house extension, new white goods, and holidays and so on. Inward investment therefore can act as a trigger to generating wealth in the local economy. If a MNC is attracted to an area then this might also lead to other smaller firms in the supply chain deciding to locate in those areas. Other firms providing services to these firms are then attracted to the area and so on.

Honda located a factory in Swindon, Wiltshire, a town known for its railway industry. Now the town is synonymous with car manufacturing. The Honda plant was an investment of over £1.3 billion. It is one of 120 Honda manufacturing facilities in 29 different countries.

This type of wealth generation has been witnessed in many UK regions. The setting of the car manufacturing plants in Sunderland, Swindon and Derby has done much to help those regions experience a boost to the local economy. In the case of Sunderland and Derby, the investment has partly helped to offset the decline in other industries that caused unemployment. For less developed countries, inward investment can again act as a catalyst for other forms of investment. The effects of the investment might be less dramatic but nevertheless, it can be something that is seen as essential for helping a country escape from poverty.

Skills, Production Techniques and Improvements in the Quality of Human Capital: It can be argued that MNCs bring with them new ideas and new techniques that can help to improve the quality of production and help boost the quality of human capital in the host country. Many will not only look to employ local labour but also provide them with training and new skills to help them improve productivity and efficiency.

In Sunderland, one of Europe's most productive car manufacturing plants, the workers have had to get used to different ways of working and different expectations than many might have been used to if working for other British firms. In some cases this can prove a challenge but in others it can lead to improvements in motivation and productivity. The skills that workers build up can then be passed on to other workers and this improves the supply of skilled labour in the area. This makes the area even more attractive to new industry as it helps to reduce the costs of training and skilling of workers.

Availability of Quality Goods and Services in the Host Country: In some cases, production in a host country may be primarily aimed at the export market. However, in other cases, the inward investment might have been made to gain access to the host country market to circumvent trade barriers. In the case of many Japanese car manufacturers the investment made into UK production has enabled them to get a foothold in the EU and to avoid tariff barriers. The UK has had access to high quality vehicles at cheaper prices and the competition this has created has also led to improvements in working practices, prices and quality in other related industries.

The location of businesses in different countries might mean the availability of high quality and relatively cheap products being available to the home market.

Tax Revenues: For the host country, there is a likelihood that the MNC will have to be subject to the tax regime in that country. As a result, many MNCs pay large sums in taxes to the host government. In less developed countries the problem might be that there is a large amount of corruption and bad governance and as a result MNCs might not contribute the tax revenue they could and even if they do it might not find its way through to the government itself.

Improvements in Infrastructure: In addition to the investment in a country in production or distribution facilities, a company might also invest in additional infrastructure facilities like road, rail, port and communications facilities. This can provide benefits for the whole country.

The costs can be summarised in the points below - for the most part, the costs are closely linked to the benefits but it will depend on the extent of the benefits that might arise as a result of the activity of the MNC.

Employment might not be as extensive as hoped - many jobs might go to skilled workers from other countries rather than to domestic workers. There might be a limit in the effect on the local economy - it will depend on how big the investment into the local economy actually is.

Some MNCs may be 'footloose'; this means that they might locate in a country to gain the tax or grant advantages but then move away when these run out. As a result there might not be a long term benefit to the country. How many new jobs are created depends on the type of investment. Investment into capital intensive production facilities might not bring as many jobs to an area as hoped.

The size and power of multinationals can be used, it is argued, to exploit weak or corrupt governments to get better deals for the MNC. Mittal, for example, a major steel producer negotiated a $900 million deal to secure rights to mine iron ore in Liberia. The government that negotiated the deal was not elected. When a new, elected government came to power, they re-negotiated the deal and took the investment to well over $1 billion.

Pollution and Environmental Damage: Some countries may have less rigorous regulatory authorities that monitor the environmental impact of MNC activities. This can cause long term problems. In India, Coca-Cola has been accused of using up water supplies in its bottling plant in Kerala in Southern India and also of dumping waste products onto land and claiming it was useful as fertiliser when it appeared to have no such beneficial properties.

Production can cause problems in any country, but in some countries the rules may be less rigorously enforced.

De-Merit Goods: Some companies might be producing goods that are not beneficial. Examples might include tobacco products and baby milk - mentioned earlier.

Repatriation of Profits: Profits might go back to the headquarters of the MNC rather than staying in the host country - the benefits, therefore, might not be as great.

MERITS OF MULTINATIONAL COMPANIES

Multinationals offer advantages to host countries as well as to the countries of their origin as explained below:

Advantages of the MNC's to the Host Countries

(i) *Raise the Rate of Investment:* MNC's raise the rate of investment in the host countries and thereby bring rapid industrial growth accompanied by massive employment opportunities in different sectors of the economy.

(ii) *Facilitate Transfer of Technology:* Multinationals act as agents for the transfer of technology to developing countries and thereby help such countries to modernize there industries. They remove technological gaps in developing countries by providing techno-managerial skills.

(iii) *Accelerate Industrial Growth:* Multinationals accelerate industrial growth in host countries through collaborations, joint ventures and establishment of subsidiaries and branches. They facilitate economic growth through financial, marketing and technological services. MNC's are rightly called "messengers of progress".

(iv) *Promote Export and Reduce Imports:* MNC's help the host countries to reduce the imports and promote the exports by raising domestic production. Marketing facilities at global level are provided by MNC's due to their global business contacts.

(v) *Provide Services to Professionals:* MNC's provide the services of the skilled professional managers for managing the activities of the enterprises in which they are involved/ interested. This raises overall managerial efficiency or enterprises connected with multinationals. MNC's bring managerial revolution in host countries.

(vi) *Facilitate Efficient Utilization of Resources:* Multinationals facilitate efficient utilization of resources available in host countries. This leads to economic development.

(vii) *Provide Benefits of R&D Activities:* Multinationals has enormous resources at their disposal. Some are utilized for R and D activities. The benefits of R and D activities are passed on to the enterprises operating in the host countries.

(viii) *Support Enterprises in Host Countries:* MNC's support to enterprises in the host countries in order to support their own operations indirectly. This is how MNC's support enterprises in the host countries to grow. Even consumers get new goods and services due to the operations of MNC's.

(ix) *Break Domestic Monopolies:* MNC's raise competition in the host countries and thereby break domestic monopolies.

Advantages of Multinationals to Home Countries

(i) *Facilitate Inflow of Foreign Exchange:* MNC's collect funds from the enterprises of other countries in the form of fees, royalty, and service charges. This money is taken to the country of their origin. MNC's make their home countries rich by facilitating inflow of foreign exchange from other countries.

(ii) *Promote Global Co-operations:* MNC's provide co-operation to poor or developing countries to develop their industries. The countries of their origin participate in such international co-operation, which is beneficial to all countries- rich and poor.

(iii) *Ensure Optimum Utilization of Resources:* MNC's ensure optimum utilization of natural and other resources available in their home countries. This is possible due to their worldwide business contacts.

(iv) *Promote Bilateral Trade Relations:* MNC's facilitate bilateral trade relations between their home countries and the other countries with which they have business relations.

DEMERITS OF MULTINATIONAL COMPANIES

(i) *Provide Outdated Technologies:* MNC's design the technologies, which can be used in different countries. They don't supply technology to poor countries for industrial development but for profit maximization. The technologies designed for profit maximization and not purely for meeting the needs of developing countries. The technologies supplied may be costly and may be outdated and obsolete or may not be suitable for the needs of developing countries.

(ii) *Harm the National Interests:* The activities of MNC's in the host countries may be harmful to the national interests as MNC's are solely guided by the profit maximization. They ignore the interests of host countries. MNC's even make profits at the cost of developing countries.

(iii) *Charge Heavy Fees:* MNC's charge heavy fees and service charges from the enterprises in the host countries. They repatriate profits of their subsidiaries to their home countries. This leads the outflow of countries.

(iv) *Develop Monopolies:* MNC's restrict competition and acquire monopoly power in certain areas in the host countries.

(v) *Use Resources Recklessly:* MNC's use the resources in the host countries in a very reckless manner, which leads to fast reduction of non-renewable natural resources.

(vi) *Dominate Domestic Policies:* MNC's use their money power for political purposes. They take undue interest in political matters in the host countries. MNC's are being openly termed as an extension of the imperialistic forces.

(vii) *Adverse Effects on Life Style/Culture:* MNC's create demand for goods and services in developing countries through advertising and sales promotion techniques. As a result, people purchase costly/ luxury goods which are not really useful nor within their capacity to purchase. MNC's create adverse effects on the cultural background of many developing countries.

(viii) *Interfere in Economic and Political Systems:* They put indirectly pressures for the formulation of policies that are favourable to them. They even topple the government in the host countries if its policies are against the MNC's and their operations.

(ix) *Avoid Tax Liabilities:* Transfer pricing enables multinational corporations to avoid taxes by manipulating prices in the case of intra company transactions.

(x) *Lead to Brain Drain in Developing Countries:* Multinationals are now entering in countries like India in a bigger way. They hire qualified technocrats and managerial experts. These people work for a few years in India, acquire experience and relocated as experts in Singapore, Korea or the United States for managing the activities of MNC's. This leads to brain drain in developing countries.

MNC'S have helped and also harmed the developing countries. It is a peculiar mixture of virtues and vices, boons and banes. However no country can afford to avoid MNC's only because it has dangers associated with them. It may be concluded that MNC's constitute a mixed blessing to developing countries. They are helping as well as harming the developing countries. It is rightly said "MNC's are bound to exist and developing countries have to learn to live with them".

LESSON ROUND UP

– Business ranges in size from the single proprietor at one extreme to the large multinational at the other which employs thousands of people over several countries.

– The classification of enterprises based on scale of business :

- Micro Enterprises
- Small Scale Enterprises: Small Scale Industries (SSI) constitutes an important and crucial segment of the industrial sector. They play an important role in employment creation, resource utilization and income generation and helping to promote changes in a gradual and phased manner.
- Large Scale Enterprises: refers to those industries which require huge infrastructure, man power and a have influx of capital assets.
- Public Enterprises: business activities were left mainly to individual and private organizations, and the government was taking care of only the essential services such as railways, electricity supply, postal services etc.

– The term public enterprise denotes a form of business organisation owned and managed by the state government or any other public authority.

– Multinational corporations (MNCs) are key agents transforming the international political and economic landscape. Because they are highly visible organizations with great power and mobility, they inspire both awe and fear.

GLOSSARY

Micro Credit Micro credit, or microfinance, is banking the unbankables, bringing credit, savings and other essential financial services within the reach of millions of people who are too poor to be served by regular banks, in most cases because they are unable to offer sufficient collateral.

Bilateral Trade Agreements The exchange of goods between two countries. Bilateral trade agreements give preference to certain countries in commercial relationships, facilitating trade and investment between the home country and the foreign country by reducing or eliminating tariffs, import quotas, export restraints and other trade barriers. Bilateral trade agreements can also help minimize trade deficits.

SELF-TEST QUESTIONS

1. What are varied scales of business? List them.
2. Define Small business and discuss its characteristics.
3. Explian the concept and features of MNCs with suitable examples.
4. "MNCs are mixed blessings to the developing economies" Comment.
5. Distinguish between:
   (i) Small Business and Large Business
   (ii) Public enterprise and MNCs
   (iii) Departmental Undertaking and Public Corporation
   (iv) Government Company and Statutory Corporation
   (v) Departmental Undertaking and Government Company.

Suggested Reading

(i) Business Organisation and Management – *by C.B. Gupta, Mayur paperbacks.*

Lesson 4
Emerging Trends in Business

LESSON OUTLINE

- Network Marketing
- Franchising
- Business Process Outsourcing (BPO)
- E-Commerce
- M-Commerce
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

The field of business analytics has improved significantly over the last few years, providing businessmen with better insights. It's like having a window open into the future where you get to discover today, (before anyone else) the direction for tomorrow. It's the greatest source of ideas for businesses that don't even exist yet. Unique, powerful ideas no one is taking advantages of, but yet have huge built-in growing demand.

Basing a business on a new emerging trend will be a success because it is riding a brand new wave of what consumers want before anyone else figures it out. A new wave of entrepreneurs coupled with advances in technology has lead to a changing business environment. Although the elements of these trends have been around for years, the trends themselves emerge when the timing is right and when several factors come together.

Various forms of business organisations have emerged in recent era which ranges from widely known franchising to relatively new E-commerce and M-commerce.

This lesson deals with emerging business types in line with the dynamic world.

No matter what your product is, you are ultimately in the education business. Your customers need to be constantly educated about the many advantages of doing business with you, trained to use your products more effectively, and taught how to make never-ending improvement in their lives.

Robert G Allen, Entrepreneur, Author, and Motivational Speaker

NETWORK MARKETING

Meaning

A business model in which a distributor network is needed to build the business. Usually this term is also well versed as Multilevel Marketing in which payouts occur at more than one level.

Network Marketing is a mode of direct marketing by the manufacturer. It consists of recruiting independent business persons who act as distributors of company's products. Each distributor can further engage sub-distributors who can further add other distributors and so on. Thus, a network of distributors is formed who operate at various levels. In simple words, it is a method of marketing that utilizes independent representatives to reach potential customers that a company otherwise would not reach with traditional online or offline marketing methods. Network marketing distributors purchase products at wholesale prices, and may either use discounted products themselves or retail the products to others for a profit. In addition, distributors receive a commission for their 'personal volume', which is the value of every product they personally buy or sell. Further, distributors receive a net commission on the total turnover they had created from their group personal volume. Network marketing is a type of business opportunity that is very popular with people looking for part-time, flexible businesses. Some of the best-known American companies in India are Avon, Oriflamme, Tupperware, Amway and so on, fall under the network marketing umbrella.

Network marketing programs has a advantage of lot upfront investment-usually only a few hundred rupees for the purchase of a product sample kit and the opportunity to sell a product line directly to friend, family and other personal contacts. Most network marketing programs also ask participants to recruit other sales representatives like in insurance sector.

Thus, under network marketing the product reaches the customers from the manufacturers via distributors. No formal marketing infrastructure is required. The distributor's compensation includes a percentage of sales of those engaged by the distributors as well as earnings on direct sales to customers.

Advantages of Network marketing

Network marketing offers the following advantages:

1. The distribution network grows continuously. Direct selling method in which independent-agent serve as distributors of goods and services and are motivated to build and manage their own sales force by recruiting and training other distributors. Hence, it becomes easier to enter new markets through growing networks.
2. In this the distribution channel is at Zero Level where firm is selling goods to distributors directly which reduces the additional overheads of firm like advertisement expenditure and retailer margin. Hence, the network companies can maintain higher margins on their products.
3. Lower overhead costs as no infrastructure is required under network marketing. Therefore, the distributor gets a chance to do business with the company without any heavy investment or liability.
4. Having successful Networking business any distributor can get the opportunity to earn unlimited income in form of commission earned on his own sales revenue, as well as on the sales revenue of the sales force created by their agent or recruits.

Disadvantages of Network Marketing

The disadvantages of network marketing are as under:

1. Sales forecasting is difficult. This often results in under or over stocking of various product items. With this process net worker usually need a huge down line to make good sales volume, which cannot be clearly predicted.
2. Distributors often become the largest customers and hence take over the control of the company. It becomes difficult for the manufacturer to exercise effective control over his sales team.
3. There is some risk concerned in becoming capitalist and joining these businesses, 95% of new MLM entrepreneur will fall short at their business within the initial three months as it is depending on marketing strategies which fizzle out when networker needs extra effort other than their core line work.

FRANCHISING

Meaning

A 'franchise' means the special right given by a manufacturer or a parent organization to another individual or firm to sell to the former's product or service in a specified given area(s). In other words, where a firm allows another firm in a foreign market to use its technical know-how and trade mark, it is known as franchising. The individual or firm which grants right is called franchiser. The individual or firm to whom the right is granted is called franchisee. The right granted by a franchiser to a franchisee is given under a special agreement known as the Franchise Agreement. A franchiser may have such agreement with more than one franchisee. Thus, franchising is a term which defines the business relationship between two organizations where a franchiser, who is the owner of a brand name, product, or system of a business, permits a franchisee to use its brand, product, or business process for a fee. This approach combines a proven, operating formula given by the franchiser with local knowledge and entrepreneurial initiative (possessed by the franchisee).It is appropriate for firms that have developed such a formula.

Franchising is the practice of using another firm's successful business model. The word 'franchise' is of Anglo-French derivation from the word franc which means 'free'. For the franchisor, the franchise is an alternative to building 'chain stores' to distribute goods and avoid investment and liability over a chain. The franchisor's success is the success of the franchisees. The franchisee is said to have a greater incentive than a direct employee because he or she has a direct stake in the business.

In a nutshell, franchising is a business system where under the franchisor grants a license to the franchisee to use the franchisor's diverse intellectual property rights, namely, know-how, designs, brands, trade marks, patents, and trade secrets along with the franchisor's proven name, reputation and marketing techniques to market the franchisor's products or services in return for a sum of money. The franchisor provides training and continuous assistance to the franchisee.

Features of Franchising

The salient features of franchising are as follows:

1. The franchiser allows the franchisee to use his trade mark under a license.
2. The franchise agreement requires the franchisee to follow franchiser's policies regarding mode of operation of business.
3. The franchiser provides marketing support and technology to the franchisee to carry on business in the manner specified by the franchise agreement. Thus, franchiser virtually sets up the business for the franchisee.
4. The franchiser may also arrange for the training of personnel working in the franchisee organization.

5. The franchisee pays to the franchiser a sum of money (called royalty) for using his business know-how and trade mark.
6. The right to use the business know-how and trade mark of the franchiser is for a limited period of time defined in the franchise agreement. However, the franchise agreement may be renewed from time to time.

Advantages of Franchising

There are so many benefit both the franchiser and franchisee.

TO THE FRANCHISER

1. The franchiser can expand his distribution system in the least possible time.
2. The franchiser is able to expand the business with little extra capital for the outlet.
3. The franchiser gets important feedback about the popularity of the product and specific need and preferences of the local customers from the franchisees.
4. Franchising enables the franchiser to increase his goodwill and reputation by expanding his network.
5. The franchiser gains wider acceptance of his brand name through the franchisees.
6. The rights of the franchiser are protected as only the franchisee can use the franchiser's patents, trade mark, brand names, etc.

TO THE FRANCHISEE

1. The business is based on a proven ides. The franchisee can check out how successful other franchisees are before committing himself.
2. The franchisee can get assistance from the franchiser in training his staff, promotion of the product, designing store layout ets.
3. The franchisee can get assistance from the franchiser in training his staff, promotion of the product, designing store layout etc.
4. There are greater chances of success of the franchisee because the brand of the franchiser is well known.
5. The franchise ensures a high degree of quality control. This enables the franchisee to satisfy his customers by offering quality products.
6. The franchisee enjoys exclusive rights in his territory. The franchiser won't sell any franchises in the same region.

Disadvantages of Franchising

TO THE FRANCHISER

1. There is a danger that the franchisee may start an identical business with slightly different brand name.
2. The franchiser's brand name and reputation may get tarnished if the franchisee is not able to maintain standards of quality and service.
3. The franchiser has to provide initial financial assistance and support in the form of staff training, advertising etc.
4. There is a risk of trade secrets getting leaked out in the foreign market. The leakage may cause serious losses.

5. There are ongoing costs of supporting the franchisee and national advertising.

TO THE FRANCHISEE

1. The franchisee does not enjoy complete freedom in his business. The franchise agreement generally contains restrictions on haw the franchisee would run the business.
2. Payment of royalty on a regular basis is to be made to the franchiser.
3. There is always a possibility of conflict between the parties regarding maintenance of accounts, payment of royalty, violation of quality norms, etc. It may sometimes lead to litigation between the franchiser and franchisee.
4. The franchisee cannot sell his business without taking approval from his franchiser.

Difference between Franchising/ Distributorship/ Agency

The terms franchise, distribution and agency are often misunderstood. Distribution and agency are the more traditional forms of distributing goods or services. However, they do not allow the principal to exert any real control over the distributor or the agent. The key distinguishing feature of a franchise is the higher degree of control that a franchisor exercises over a franchisee. The franchisor has a say in all important issues such as branding, methodology and mergers. Although corporate entities such as subsidiaries or joint ventures allow as much if not more control than a franchise, they entail a much higher financial risk.

BUSINESS PROCESS OUTSOURCING (BPO)

Meaning

Outsourcing is popularly associated with IT Enabled Services (ITES) and is also known as Business Process Outsourcing (BPO). Knowledge process outsourcing (KPO) and legal process outsourcing (LPO) are some of the sub-segments of business process outsourcing industry.

It is a subset of outsourcing that involves the contracting of the operations and responsibilities of specific business functions (or processes) to a third-party service provider. Originally, this was associated with manufacturing firms, such as Coca Cola that outsourced large segments of its supply chain. In the contemporary context, it is primarily used to refer to the outsourcing of business processing services to an outside firm, replacing in-house services with labor from an outside firm.

BPO is typically categorized into back office outsourcing - which includes internal business functions such as human resources or finance and accounting, and front office outsourcing - which includes customer-related services such as contact centre services. In other words, ‘Customer Care’ account for the bulk of call centre activities with 24x7 handling of inbound(customer queries and grievances) and out-bound activities(customer surveys, payment follow up, and telemarketing).

BPO that is contracted outside a company's country is called offshore outsourcing. BPO that is contracted to a company's neighboring (or nearby) country is called near shore outsourcing.

There has been a tremendous growth in the number and size of call centers which provide customer-oriented voice based services to their clients. IT Outsourcing is just similar to any other type of overseas development services. Now a day Offshore Software Development is expanding all over the world. Previously, outsourcing decision was as simple as checking the budget, experience of the service provider and present in-house ability. India is the hottest spot of the IT outsourcing. The reasons are that India has supportive government policy, advanced Technology, reliable communication facilities, huge skilled man power with proficiency in English language.

Need for Outsourcing of Services

The need for outsourcing arises because of the following factors:

(i) *Specialized Performance:* Through outsourcing, a firm can get various tasks done by specialized agencies. For example, it may entrust repair and maintenance of air conditioner and other electronic gadgets to a specialist firm.

(ii) *Getting Better Results:* A firm can't have specialization in all activities and so it can entrust some activities to outside agencies. For example, it may outsource advertising activity to an advertising agency for better result.

(iii) *Achieving Economy:* It is economical to outsource some activities rather than organizing a separate department for performing such activities. That is why, delivery of mail outsourced to courier agency by most of the firms.

(iv) *Ensuring Smooth Operations:* Outsourcing of routine activities enables the firm to conduct its operation smoothly.

(v) *Expansion of Business:* A business firm can concentrate on its growth strategies and outsource subsidiary or non-core services to outside agencies which are specialists in their respective fields.

Advantages of BPO

(i) *Flexible:* An advantage of BPO is the way in which it helps to increase a company's flexibility. However, several sources have different ways in which they perceive organizational flexibility. Therefore, business process outsourcing enhances the flexibility of an organization in different ways. Most services provided by BPO vendors are offered on a fee-for-service basis. This can help a company becoming more flexible by transforming fixed into variable costs. A variable cost structure helps a company responding to changes in required capacity and does not require a company to invest in assets, thereby making the company more flexible. Outsourcing may provide a firm with increased flexibility in its resource management and may reduce response times to major environmental changes.

(ii) *Cost-Effectiveness:* There is no doubt about this advantage of outsourcing to India. Outsourcing IT requirements save 30% of company's expenditure. One can always resort to Offshore Software Development to implement huge projects which may not be affordable to a company in the western world. Off shoring not only takes care of the development costs but also slashes hiring costs, training costs and cost of infrastructure to a great extent.

(iii) *Focus:* Another way in which BPO contributes to a company's flexibility is that a company is able to focus on its core competencies, without being burdened by the demands of bureaucratic restraints. Key employees are herewith released from performing non-core or administrative processes and can invest more time and energy in building the firm's core businesses. The key lies in knowing which of the main value driven to focus on – customer intimacy, product leadership, or operational excellence. Focusing more on one of these driven may help a company create a competitive edge.

(iv) *Speed:* BPO increases organizational flexibility is by increasing the speed of business processes. Supply chain management with the effective use of supply chain partners. Business process outsourcing increases the speed of several business processes, such as the fragmentation of core-process and non-core process in the case of a manufacturing company.

(v) *Growth:* A company can maintain growth goals while avoiding standard business bottlenecks. BPO therefore allows firms to retain their entrepreneurial speed and agility, which they would otherwise sacrifice in order to become efficient as they expanded. It avoids a premature internal transition from its informal entrepreneurial phase to a more bureaucratic mode of operation. Finally, flexibility is seen as a stage in the organizational life cycle

(vi) *Skilled Manpower:* India has a large pool of technically skilled and English proficient population, thus making it favorable for making it an outsourcing partner. A company may be able to grow at a faster pace as it will be less constrained by large capital expenditures for people or equipment that may take years to amortize.

Disadvantages of BPO

Although the above-mentioned arguments favor the view that BPO increases the flexibility of organizations, management needs to be careful with the implementation of it as there are issues, which work against these advantages.

(i) *Communication Challenges and Different Standards:* Sometimes in the business of Outsourcing communication problems are usually comes. For the better communication service provider have to use email and instant messaging program because it's online communication. Sometimes telephone communication is the obstacle for this business.

(ii) *Time Zone – a Double Edged Sword:* Time zone would be creating disadvantages of outsourcing. Because vendors and customers are in the different countries so in that case they have to understand the difference between time for online meetings and requirement between the customers and vendors.

(iii) *Loss of Control:* Because of some misunderstanding company will lose control on all over project in that case company has to clear all things. That means transparency must have to in the business of Outsourcing.

(iv) *Service Provider wants to Diversify and take more Projects:* To diversify the business of IT Outsourcing, service providers' wants to take more projects and in that case sometimes they cannot give better preference for all projects.

(v) *Customer is Novice:* Many a times, customer is novice and in the effort to satisfy him, the project may go haywire.

(vi) *Other Problems, which arise in Practice, are:* A failure to meet service levels, unclear contractual issues, changing requirements and unforeseen charges, and a dependence on the BPO which reduces flexibility. Consequently, these challenges need to be considered before a company decides to engage in business process outsourcing.

A further issue is that in many cases there is little that differentiates the BPO providers other than size. They often provide similar services, have similar geographic footprints, leverage similar technology stacks, and have similar quality improvement approaches.

E-COMMERCE

Meaning

'Electronic commerce' refers to all forms of business transactions which are carried out through electronic processing and transmission of data including text, sound and visual images. The term electronic commerce or e-commerce as it is popularly known; refers to a comprehensive system of trading that uses networks of computers for buying and selling of goods, information and services. Using information and communication technology, e-commerce can take place i) between companies, ii) between companies and their customers, and iii) between companies and government departments.

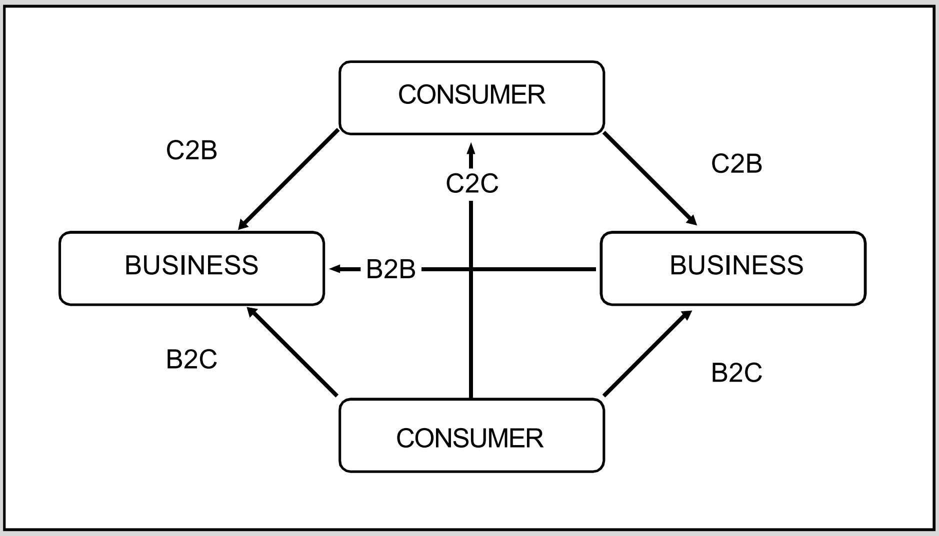
Thus, e-commerce includes buying and selling of -

– Goods- e.g. digital cameras, music systems, clothes, accessories
– Information- e.g. subscription to some law site may give access to some court cases
– Services- e.g. matrimonial services through shaadi.com, placement services through naukri.com

Classification of E-Commerce

Based upon the entities involved in transaction, electronic commerce has been classified into following categories:

– Business-to-Business (B2B)
– Business-to-Consumer (B2C)
– Consumer-to-Business (C2B)
– Consumer-to-Consumer (C2C)



Classification of E-Commerce

Advantages of E-Commerce

E-Commerce is gaining popularity because it offers the following benefits.

(i) *Global Market:* E-Commerce enables business firms to reach out to customers all over the world who have an access to internet. Thus, the whole world becomes a potential market for business enterprises.

(ii) *Lower Transaction Cost and Higher Margin:* E-Commerce reduces the cost of business transactions substantially. For instance, the number and cost of customer service representatives in a bank can be reduced by using net banking. An e-commerce firm can earn higher margins as the transaction costs are reduced to a great extent.

(iii) *Quick Delivery:* It increases customer satisfaction through quick delivery of goods and redressal of customer complaints, if any. The customer need not visit the business firm for making purchases or redressal of grievances.

(iv) *Saving of Time and Effort:* There is paperless exchange of information. This saves a lot of time, money and energy in receiving orders and executing the same under the traditional mode of commerce. Thus, less clerical work is involved.

(v) *24x7 Working:* A website is open all 24 hours, 7 days in a week, it can, thus, take orders and keep an eye on delivery of goods and receive payments at any time. A business firm can provide information about its products and services to customers around the clock.

(vi) *Quick Supplies:* The business firm can get quick supplies from the vendors. It need not maintain huge inventories of material. Thus less capital is blocked in the inventories.

(vii) *Wider Choice:* For the consumers, the whole world becomes a shop. They can look at and evaluate the same product at different websites before making a purchase decision.

(viii) *Customer Convenience:* Customers can shop from home or office. They don't need to stand in long queues to talk to a salesman. They can read details regarding model numbers, prices, features etc. of the product from the website and purchase at their own convenience. Payments can also be made online.

(ix) *Direct Contact between Business and Consumer:* E-Commerce enables business firms to establish a direct contact with their customers by eliminating middlemen. It allows quick response to the queries of customers and other business houses through the internet.

(x) *Launching of New Products:* It is easier to launch a new product through the internet. Complete information about the product can be provided over the internet. E-Mail about the launch of the new product can be sent to the dealers and the customers. So, it can be used as a tool of sales promotion.

Disadvantages of E-Commerce

(i) *High Start-Up Costs:* The various components of costs involved with e-Commerce are :

– Connection costs to the Internet (i.e. direct link).

– Hardware/Software: This includes costs of sophisticated computer, modem, routers,etc.

– Set Up: This includes employee work hours involved in designing and installing of a suitable website.

– Maintenance: This includes costs involved in training of employees and maintenance of Web-pages.

(ii) *High Risk:* Many stories unfolded in 1999 about successful executives in established firms leaving for Internet starts-up, only to find out that their 'get rich' dream with dot.com was just a dream. However, many dot.com organizations failed in 2000 and later due to various reasons like lack of good revenue model, problem related to customer satisfaction, etc.

(iii) *Training and Maintenance:* Organizations require trained staff to initiate, update and maintain the Internet facilities and Web pages. Some of the issues involved with training and maintenance can be handled by out- sourcing certain functions and services. This would alleviate the need for the organizations to have adequate Internet server configuration backup and 24 hour support environment.

(iv) *Fulfillment Problems:* Tales of shipping delays, merchandise mix-ups, and Websites crashing under pressure are some of the common problems. Customer confidence in e- Commerce ability to deliver during heavy shopping seasons continues to be headache.

(v) *Lack of Personal Touch:* The first important problem with e- commerce is the lack of warmth of inter-personal interactions between the seller and the buyer. That is why, e-commerce is not suitable where the customer requires personalized service as in case of customized dress or interior decoration.

(vi) *Security:* Security continues to be a problem for online business. Many people are reluctant to give out their credit card numbers via the Internet. For millions of potential cyber- customers, the fear of credit card theft is a real one. Customers have to feel confident about the integrity of the process before they commit to the purchase.

(vii) *System and Data Integrity:* Data protection and integrity of the system that handles the data are serious concerns. Computer viruses are rampant, with new viruses discovered every day. Viruses causes unnecessary delays, file backups, storage problems, and the like. The danger of hackers accessing files and corrupting accounts adds more stress to the already complex operations.

(viii) *Corporate Vulnerability:* The availability of product details, catalogues, and other information about a business through its Websites makes it vulnerable to access by the competitors. The idea of extracting business intelligence from the competitors Web pages is called Web Farming.

(ix) *People's Resistance:* Imagine a Website called furniture.com or living.com, where venture capitalists are investing millions in selling home furnishings online. In the case of sofa, one would want to sit on it, feel the texture of the fabric, etc. Besides the 'testing and feeling' factor, online furniture stores face costly returns and the kinds of deliveries that cannot be expedited.

M-COMMERCE

Meaning

M-Commerce or mobile commerce refers to the buying and selling of goods and services through wireless handheld devices such as mobile phone and personal digital assistants (PDAs). M-Commerce enables the users to access the internet without needing to find a place to plug in. The basic idea of M-Commerce is to distribute information and thus to generate business in a mobile way.

M-Commerce is the ability to conduct commerce using a mobile device, such as a mobile phone, a Personal Digital Assistant (PDA), a smart phone, or other emerging mobile equipment such as dash top mobile devices. Mobile Commerce is any transaction, involving the transfer of ownership or rights to use goods and services, which is initiated and/or completed by using mobile access to computer-mediated networks with the help of an electronic device.

M-Commerce is about the explosion of applications and services that are becoming accessible from Internet-enabled mobile devices. It involves new technologies, services and business models. It is quite different from traditional e-commerce. Mobile phones impose very different constraints than desktop computers. But, this opens the door to a slew of new applications and services. This device follow you wherever you go, making it possible to look for a nearby restaurant, stay in touch with colleagues, or pay for items at a store.

As the Internet finds its way into our purses or shirt pockets, the devices we use to access it are becoming more personal too. Already today, mobile phones know the phone numbers of our friends and colleagues. They are starting to track our location. Tomorrow, they will replace our wallets and credit cards. One day, they may very well turn into intelligent assistants capable of anticipating many of our wishes and needs, such as automatically arranging for taxis to come and pick us up after business meetings or providing us with summaries of relevant news and messages left by colleagues. But, for all these changes to happen, key issues of interoperability, usability, security, and privacy still need to be addressed.

Advantages of M-Commerce

– A new distribution network being available to conduct commerce

– A ready convenient and secure way to do transactions

– Large reach, effective target marketing, and ability to offer location-based services

Limitations of M-Commerce

The following are the constraints in the application and growth of m-commerce.

- The existing technology is not best suited for mobile data transfer. The connections are unstable, the data transfer rate is limited, transfer duration is too long and the costs involved are high.
- Acceptance of m-commerce is slow.
- Lack of infrastructure, competing standards, poor input and display capabilities in cell phones, and human fear to learn new things are other constraints in the use of m-commerce.

Future of M-Commerce

Some application of M-commerce will become popular. These are time critical services that people will need on their way, e.g. traffic news, stock market reports. Booking tickets etc. For instance, the travel industry in realizing the possible benefits of m-commerce, is working on technologies that will take care of travel arrangement, update customers on flight status, notify them when this information changes and will offer to make new arrangements based on preset user preferences requiring no input from the user. Therefore, a customer's entire trip can be scheduled and managed using only their mobile devices.

LESSON ROUND UP

- Network Marketing: a network of distributors is formed who operate at various levels.
- Advantages of Network marketing
  - distribution network grows continuously
  - distribution channel is at zero level
  - lower overhead costs
  - successful Networking business
  - sales forecasting is difficult
  - distributors take over the control of the company.
- Franchising: A 'franchise' means the special right given by a manufacturer or a parent organization to another individual or firm to sell to the former's product or service in a specified given area(s).
- Advantages and Disadvantages of Franchising are faced by both franchiser and franchisee.
- Business Process Outsourcing (BPO): involves the contracting of the operations and responsibilities of specific business functions (or processes) to a third-party service provider
- E-Commerce: Electronic commerce refers to all forms of business transactions which are carried out through electronic processing and transmission of data including text, sound and visual images.
- Classification of E-Commerce
  - Business-to-Business (B2B)
  - Business-to-Consumer (B2C)
  - Consumer-to-Business (C2B)

- Consumer-to-Consumer (C2C).

– M-Commerce: M-Commerce or mobile commerce refers to the buying and selling of goods and services through wireless handheld devices such as mobile phone and personal digital assistants (PDAs).

GLOSSARY

Network Marketing	It is form of direct marketing where customers become distributors.
Franchising	A franchising is a business form where a right is granted to an individual or group to market a company's goods or services within a certain territory or location.
Franchiser	A party in a franchising enterprise that ultimately owns the rights, trademarks and proprietary knowledge of the specific business entity.
Franchisee	A party that is granted a franchise, as to market a company's goods or services in a certain local area.
Business Process Outsourcing	BPO is the process of hiring another company to handle business activities for you.
E-Commerce	The buying and selling of products and services by businesses and consumers through an electronic medium, without using any paper documents. E-commerce is widely considered the buying and selling of products over the internet, but any transaction that is completed solely through electronic measures can be considered e-commerce.
Business-to-Business	This model defines that Buyer and seller are two different entities. It is similar to manufacturer issuing goods to the retailer or wholesaler.
Business-to-Consumer	B2C is the online business model to sell to individuals. The basic concept of this model is to sell the product online to the consumers. Interaction between business and consumers.
Consumer-to-Business	The online model where consumers interact with businesses. For example: Feedback.
Consumer-to-Consumer	It is the model where online dealing of goods or services among people takes place. Though there is no major parties needed but the parties will not fulfill the transactions without the program which is supplied by the online market dealer such as eBay.
M-Commerce	It deals with conducting the transactions with the help of mobile. The mobile device consumers can interact with each other and can lead the business. Mobile Commerce involves the change of ownership or rights to utilize goods and related services.

SELF TEST QUESTION

1. What do you understand by Network Marketing? Why is it also called "multilevel marketing"?
2. What is franchising? How does it work explain with examples.

3. Explian the opportunities for E-Commerce. What are limitations of E commerce?
4. Define M-Commerce and expalin its significance.
5. Distinguish between:
   (i) Commerce and E-Commerce
   (ii) E-Commerce and M-Commerce
   (iii) Francising and Network Marketing.

Suggested Reading

(1) Business Organisation and Management – by C. B.Gupta, Mayur paperbacks.

Lesson 5
Business Functions

LESSON OUTLINE

- Business Functions
- Meaning of Strategy
- Strategy at Different Levels of a Business
- Supply Chain
- Finance
- Financial Planning
- Marketing Management
- Difference between Marketing and Selling
- Human Resource
- Services
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

The expansion and increased relative weightage of activities related to businesses have continued to grow all along the 1990s and the beginning of the 21st Century, not only in the Indian economy but also for the global economy as a whole. At the outset of this new era, there is an rage for entrepreneurship among people and with the tremendous increase in business activities, the essentials of business functions have also gained importance. The business functions allow improving the efficiency of business activity by classifying them in specific heads and understanding the roots.

A business function is a concept used in organisation for defining the role of enterprise. An organisation sets the business functions on which different units of business are structured.

Thus, the aim of this study is to evaluate the functions and dynamism of business functions with respect to rapidly changing world with increased global integration.

Business has only two functions - Marketing and Innovation.

Peter F. Drucker

BUSINESS FUNCTIONS

Business function is a process or operation that is performed routinely to carry out a part of the mission of an organization. The series of activities undertaken to create a product or deliver a service. Companies often lay down specific rules for business process to ensure activities are completed in an organized and efficient manner. Business process may involve division of labor between multiple persons and/or technologies. For example, in a publishing company, one person may write material, a second may edit it, a third may add graphics, and a fourth may print it. Business process is also called business function

A Business Function is a concept used in the Organisation Architecture domain and represents what work is done by that organisation, organisation unit or business role. An organisation can be designed as a set of Business Functions and usually the structure of the organisation units within an organisation is closely based on the business functions.

Those Business Functions are more stable than the organisation structure itself and often an Organisation Unit or Business Role may be responsible for multiple business functions. A Business Function is only ever carried out by a single Business Role/Organisation Unit within an organisation.

Meaning of Strategy

The term strategy is derived from the Greek word 'Strategos' which means 'the art of the general'. This concept was primarily used in military science where it implies the plan to win the battle. In context of business, strategy is a plan specially designed to match the potential of competitors. Strategy reflects managerial response to changes in business environment.

"Strategy is the direction and scope of an organisation over the long-term: which achieves advantage for the organisation through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfill stakeholder expectations."

Some features of strategy are as follows :

- It is a specialized planning to retaliate competitors.
- It explains how managers have to respond to changes in business environment.
- It redefines direction towards common efforts.
- It reflects concern to effectively mobilize resources.
- It maximizes chances to achieve objectives.
- Formulating strategies is the job of top management.

Strategy at Different Levels of a Business

Strategies exist at several levels in any organisation - ranging from the overall business (or group of businesses) through to individuals working in it.

Corporate Strategy - is concerned with the overall purpose and scope of the business to meet stakeholder expectations. This is a crucial level since it is heavily influenced by investors in the business and acts to guide strategic decision-making throughout the business. Corporate strategy is often stated explicitly in a "mission statement".

Business Unit Strategy - is concerned more with how a business competes successfully in a particular market. It concerns strategic decisions about choice of products, meeting needs of customers, gaining advantage over competitors, exploiting or creating new opportunities etc.

Operational Strategy - is concerned with how each part of the business is organised to deliver the corporate and business-unit level strategic direction. Operational strategy therefore focuses on issues of resources, processes, people etc.

Planning

Planning Defined :

William H. Newman and Charles E. Summer, Jr. say that ---'' the process of planning cavers a wide range of activities , all the way from initially sensing that something needs doing to firmly deciding who does what when.....It is more than logic or imagination of judgement . It is a combination of all these that culminates in a decision – a decision about what should be done. The decision phase of planning is so important that we shall use the expression 'decision-making' as a synonym of planning."

Richard N. Farmer and Barry M. Richman observe that "the planning function determines organizational objectives and the policies, programmes, schedules, procedures, and methods for achieving them. Planning is essentially decision-making since it involves choosing among alternatives and it also encompasses innovation. Thus, planning is the process of making decisions on any phase of organized activity."

Meaning of Planning

This step involves mapping out exactly how to achieve a particular goal. Say, for example, that the organization's goal is to improve company sales. The manager first needs to decide which steps are necessary to accomplish that goal. These steps may include increasing advertising, inventory, and sales staff. These necessary steps are developed into a plan. When the plan is in place, the manager can follow it to accomplish the goal of improving company sales.

Planning is the primary function of management. It is basically an intellectual process; it requires determination of the action and the basing decision on purpose, knowledge, and considered estimates.

It has been pointed out that nowadays, great emphasis is placed on planning by modern management which strive for their organizations' survival, growth and healthy mode of operations. A manager desires to provide stability to his efforts by considering many complicated future variables since the future involves change and uncertainity. Moreover, planning is necessary to achieve results through the efforts of others. Hence, a manager must plan the efforts required to achieve the desired results. The main principle of planning is that adequate planning or mental effort must take place.

Although all managers plan, the work schedule of the first-line supervisors differs from strategic plan developed by top managers. Roger Smith, the chief executive officer at General Motors planned the grand strategy of producing small cars in Japan and Korea. Chairman Fuaber of K-Mart, a retailer known for its no-frills discount stores, planned to "upscale" the operation by offering a wider selection and higher- margin apparel. Thorton Bradshaw of the RCA Corporation redirected strategy, moving the company away from videodiscs and selling unrelated businesses. He focused instead on the company's strengths in communication satellites and radar display systems produced for the Navy. While top executives plan the general direction of the firm, managers at all levels must prepare their plans so that they contribute to the overall aims of the organization.

Budgetary Control

A widely used device for managerial control is the budget. Indeed, it has sometimes been assumed that budgeting is the device for accomplishing control. However, many non-budgetary devices are also essential.

Budget is a financial and/ or quantitative statement, prepared and approved prior to a defined period of time of the policy to be pursued during that period for the purpose of attaining a given objective. It may include income, expenditure and employment of capital.

Concept of Budgeting : Budgeting is the formulation of plans for a given future period in numerical terms. As such, budgets are statements of anticipated results, in financial terms, as in revenue and expense and capital budgets; or in non-financial terms, as in budgets of direct –labour-hours, materials, physical sales volume, or units of production. It has sometimes been said, for example, that financial budgets represent the "dollarizing" of plans. Only when there are clear goals and actions to accomplish them can anyone in a top position of authority know how much money is necessary to do what is desired.

Budgetary Control – In this technique certain standards for performance are laid down. These standards are used to monitor, measure and regulate the actual performance. These standards are fixed for different levels of activity. Budgets are basically quantitative statements that prescribe standard set in advance. Actual performance is compared with budgets to locate the deviation if any.

Budgetary control is defined by the Institute of Cost and Management Accountants (CIMA) as:

"The establishment of budgets relating the responsibilities of executives to the requirements of a policy, and the continuous comparison of actual with budgeted results, either to secure by individual action the objective of that policy, or to provide a basis for its revision".

Some Common Types of Budgets

Type of Budget	*Purpose of Budget*
Sales Budget	Specifies expected sales of goods during a period(s).
Production Budget	Specifies volume of production during different period(s).
Material Budget	Specifies estimated quantity and cost of material during different volumes of production.
Cash Budget	Specifies expected cash inflow and outflow and net liquidity position at different time periods.
Working capital Budget	Specifies available working capital, i.e., investment in current assets like inventory, debtors, etc., at different points of time.
Profitability Budget	Specifies at different levels of sales, expected profit level.
R & D Budget	Specifies estimated expenditure to carry out research and development.

Features of Budgetary Control

1. Financial and/ or quantitative statement.
2. Futuristic- prepared and approved prior to a defined period of time.
3. Goal Oriented- for the purpose of attaining a given objective.
4. Components- Income, Expenditure and Employment of capital.

Budgeting offers the following advantages:

1. Budgeting focuses on specific and time bound targets and thus, helps in attainment of organizational objectives.

2. Budgeting is a source of motivation to the employees who know the standards against which their performance will be appraised and thus, enables them to perform better.
3. Budgeting helps in optimum utilization of resources by allocating them according to the requirements of different departments.
4. Budgeting is also used for achieving coordination among different departments of an organization and highlights the interdependence between them. For instance, sales budget cannot be prepared without knowing production programmes and schedules.
5. It facilitates management by exception by stressing on those operations which deviates from budgeted standards in a significant way.

Research and Development (R&D)

The term "research and development"- more often "R&D"- is the such common use that people tend to forget it denotes a whole range of activities. In a broad sense, R&D includes both basics or fundamental and applied research. From a business point of view, however, basic research has no immediate or direct commercial value. Therefore, only researchers involved in establishing new applications, interpreting new findings, and making discoveries that can be commercialized are of interest to business managers.

Location of Business

These days the decision about locating a start-up business is a very different one. It is possible to run a new business, even with several people, without ever having separate business premises.

The so-called "virtual business" is now a reality, made possible by easy communications and the enthusiasm of many people to work from home, as freelancers or consultants. Setting up a virtual business, often from home, is not without its problems. However, this is a very popular approach to locating a new business.

Not every kind of start-up can be based at home. When addressing the question of business location, the textbooks often use the example of a new retail business. For retailing, the search for a good location is vitally important.

In general, the most important consideration for a start-up is the cost of the business location. In such situtation, it is best to assume that a start-up has limited financial resources and that it will seek to minimise the start-up costs. Setting up in a new business location can add significantly to overheads – a business will incur rent, rates, insurance and many other on-going costs simply from the decision to take some premises.

Factors affecting Location of Business

Whatever the business, there are several general factors that influence the choice of location. These are:

Factor	Comments
Communications	This includes transport facilities (road, rail, air) as well as information infrastructure. Transport links are particularly important if the business delivers products, sells direct using a sales force or is dependent on import and export. Information technology is less of an issue these days – most start-ups can quickly establish reliable broadband Internet connections.
Labour	When a start-up needs to hire employees, then access to a reliable pool of staff with relevant skills is important. Businesses that are labour-intensive often look to locate in areas of traditionally low wages.

Market - Customers & Population	A start-up may need to be located near particular centres of population. For example, if the product is a service targeted at affluent older-aged people, then it is important to be located where there is a sufficient population of such people. Franchise businesses often analyse the population characteristics of a potential new territory before setting up in a new location.
Suppliers	The business may be dependent on supplies of a particular raw material, so costs will be lower if the business is located near the source of supply (e.g. where the raw material is grown or where a distributor is based). This factor tends to be more important for manufacturing businesses rather than service businesses.
Government Assistance	Government policy has often been designed to influence the locations of new businesses. If the start-up is "location-independent" (i.e. the other factors above don't really make a difference to the choice of location), then it may be that deals and incentives offered by Government can influence the choice. Some poorer areas of the UK are designated as "assisted areas". These include many parts of north-east England, Wales, East Yorkshire, Cornwall etc. Locating a new business in one of these areas potentially makes government grants and loans available.

There is no magic formula which can be applied to decide the most important factors in choosing a location.

Decision Making

Decision making is regarded as the mental processes resulting in the selection of action among alternative scenarios. Every decision making process produces a final choice. The output can be an action or an opinion of choice. It might be regarded as a problem solving activity which is terminated when a satisfactory solution is reached. Therefore, the decision making is a reasoning or emotional process which can be rational or irrational, can be based on explicit assumptions or tacit assumptions. This is the extended form of Planning. Hence, decision making is only efficient when it is supported by process of Planning.

Government Policy

Some models of business ignore government. They show buyers and sellers interacting in the marketplace with no legislative restrictions, no regulation, and no financing programs. If government shows up at all in these models, it is a customer and perhaps as a tax collector.

Entrepreneurs' attitudes toward government intervention often depend less on their political belief than on the state of their enterprise. Some want little government control.

SUPPLY CHAIN

Supply chain management (SCM) is the oversight of materials, information, and finances as they move in a process from supplier to manufacturer to wholesaler to retailer to consumer. Supply chain management involves coordinating and integrating these flows both within and among companies. It is said that the ultimate goal of any effective supply chain management system is to reduce inventory (with the assumption that products are available when needed). As a solution for successful supply chain management, sophisticated software systems with Web interfaces are competing with Web-based application service providers (ASP) who promise to provide part or all of the SCM service for companies who rent their service.

Supply chain management flows can be divided into three main flows:

- Product Flow
- Information Flow
- Finances Flow

The product flow includes the movement of goods from a supplier to a customer, as well as any customer returns or service needs. The information flow involves transmitting orders and updating the status of delivery. The financial flow consists of credit terms, payment schedules, and consignment and title ownership arrangements.

There are two main types of SCM software: planning applications and execution applications. Planning applications use advanced algorithms to determine the best way to fill an order. Execution applications track the physical status of goods, the management of materials, and financial information involving all parties.

Some SCM applications are based on open data models that support the sharing of data both inside and outside the enterprise (this is called the extended enterprise, and includes key suppliers, manufacturers, and end customers of a specific company). This shared data may reside in diverse database systems, or data warehouses, at several different sites and companies.

By sharing this data 'upstream' (with a company's suppliers) and 'downstream' (with a company's clients), SCM applications have the potential to improve the time-to-market of products, reduce costs, and allow all parties in the supply chain to better manage current resources and plan for future needs.

A chain is only as strong as its weakest link. the first step to supply-chain excellence is a company operating well. That means a small or large retail operation that's well organized and poised for growth.

Objectives

– Greater efficiency and lower cost

– Enhance flexibility and agility

– Improve customer service

– Optimize the value chain

Importance

The supply chain — a term now commonly used internationally — encompasses every effort involved in producing and delivering a final product or service, from the supplier's supplier to the customer's customer . Supply chain management includes managing supply and demand, sourcing raw materials and parts, manufacturing and assembly, warehousing and inventory tracking, order entry and order management, distribution across all channels, and delivery to the customer.

Supply chain management is essential to company success and customer satisfaction. It also plays a critical role in society. Its knowledge and capabilities can be used to support medical missions, conduct disaster relief operations, and handle other types of emergencies. It also plays a role in cultural evolution and helps improve our quality of life.

Production - Types of Production Method

A good way to think of a business is to imagine inputs entering an imaginary black box. What come out of the box are outputs. The black box is the business – what is does how it does it and so on.

A business needs resources in order to trade. The activities of a new business should be designed to turn those resources into products and services that customers are willing to pay for. This process is known as the "**transformation process**".

Different Terms of ‘POM’ under Supply Chain Management.

In our introduction to production and operations management ("POM") we suggested that there are several different methods of handling the conversion or production process - **Job, Batch, Flow and Group**. This revision note explains these methods in more detail.

Introduction

The various methods of production are not associated with a particular volume of production. Similarly, several methods may be used at different stages of the overall production process.

Job Method

With Job production, the complete task is handled by a single worker or group of workers. Jobs can be small-scale/low technology as well as complex/high technology.

Low technology jobs: here the organisation of production is extremely simply, with the required skills and equipment easily obtainable. This method enables customer's specific requirements to be included, often as the job progresses. Examples include: hairdressers; tailoring

High technology jobs: high technology jobs involve much greater complexity - and therefore present greater management challenge. The important ingredient in high-technology job production is **project management**, or project control. The essential features of good project control for a job are:

– Clear definitions of objectives - how should the job progress (milestones, dates, stages)

– Decision-making process - how are decisions taking about the needs of each process in the job, labour and other resources

Examples of high technology / complex jobs: film production; large construction projects (e.g. the Millennium Dome)

Batch Method

As businesses grow and production volumes increase, it is not unusual to see the production process organised so that "Batch methods" can be used.

Batch methods require that the work for any task is divided into parts or operations. Each operation is completed through the whole batch before the next operation is performed. By using the batch method, it is possible to achieve specialisation of labour. Capital expenditure can also be kept lower although careful planning is required to ensure that production equipment is not idle. The main aims of the batch method are, therefore, to:

– Concentrate skills (specialisation)

– Achieve high equipment utilisation

This technique is probably the most commonly used method for organising manufacture. A good example is the production of electronic instruments.

Batch methods are not without their problems. There is a high probability of poor work flow, particularly if the batches are not of the optimal size or if there is a significant difference in productivity by each operation in the process. Batch methods often result in the build up of significant "work in progress" or stocks (i.e. completed batches waiting for their turn to be worked on in the next operation).

Flow Methods

Flow methods are similar to batch methods - except that the problem of rest/idle production/batch queuing is eliminated.

Flow has been defined as a "method of production organisation where the task is worked on continuously or where the processing of material is continuous and progressive,"

The aims of flow methods are:

– Improved work & material flow

– Reduced need for labour skills

– Added value / completed work faster

Flow methods mean that as work on a task at a particular stage is complete, it must be passed directly to the next stage for processing without waiting for the remaining tasks in the "batch". When it arrives at the next stage, work must start immediately on the next process. In order for the flow to be smooth, the times that each task requires on each stage must be of equal length and there should be no movement off the flow production line. In theory, therefore, any fault or error at a particular stage

In order that flow methods can work well, several requirements must be met:

(1) There must be substantially constant demand

If demand is unpredictable or irregular, then the flow production line can lead to a substantial build up of stocks and possibility storage difficulties. Many businesses using flow methods get round this problem by "building for stock" - i.e. keeping the flow line working during quiet periods of demand so that output can be produced efficiently.

(2) The product and/or production tasks must be standardised

Flow methods are inflexible - they cannot deal effectively with variations in the product (although some "variety" can be accomplished through applying different finishes, decorations etc at the end of the production line).

(3) Materials used in production must be to specification and delivered on time

Since the flow production line is working continuously, it is not a good idea to use materials that vary in style, form or quality. Similarly, if the required materials are not available, then the whole production line will come to a close - with potentially serious cost consequences.

(4) Each operation in the production flow must be carefully defined - and recorded in detail

(5) The output from each stage of the flow must conform to quality standards

Since the output from each stage moves forward continuously, there is no room for sub-standard output to be "re-worked" (compare this with job or batch production where it is possible to compensate for a lack of quality by doing some extra work on the job or the batch before it is completed).

The achievement of a successful production flow line requires considerable planning, particularly in ensuring that the correct production materials are delivered on time and that operations in the flow are of equal duration.

Common examples where flow methods are used are the manufacture of motor cars, chocolates and televisions.

FINANCE

Meaning of Finance : Finance is said to be the lifeblood of an organization. The most common way to explain finance is money. Government needs money to pay salaries of staff and carry out development work, etc. Business entities need money to carry out production, pay wages, expenses and taxes. Hospitals, schools, religious bodies, etc., need money to carry their activities. Finance represent long-term and short-term requirements of an organization. It is a science of money that by its principles and methods explains how to acquire, administer and control finance. Financial management is nothing but management of limited financial resources the organisation has, to its utmost advantage. Resources are always limited, but wants are always unlimited.

Definition of Finance: According to Howard and Upton, "*Finance may be defined as that administration area or set of administrative functions in an organization may have the means of carrying out its objectives as satisfactorily as possible*."

Definition of Business Finance: According to B.O. Wheeler, *"Business finance includes those business activities which are concerned with the acquisition and conservation of capital funds in meeting the financial needs and overall objectives of business enterprise."*

Meaning of Business Finance

Money required for carrying out business activities is called business finance. Almost each and every activity requires finance. Finance is needed to establish the enterprises, to run it, to modernise it, to expand, or diversify it. The finance is required for buying a variety of assets, which may be tangible like machinery, factories, buildings; or intangible such as trademarks, patents, etc. Also finance is the central to running the day to day operations of business.

FINANCIAL MANAGEMENT

All the finances came at some cost. Financial management is concerned with optimal procurement as well as the usage of finance. The finance so procured needs to be invested in a manner that the return from the investment is more than cost of finance. Financial management aims to reduce the cost of finance. It also ensures the availability of sufficient funds. Financial Management deals with planning, organizing, directing and controlling financial activities like procurement and utilization of funds of an enterprise.

Following Definitions explain the meaning of Financial Management:

- *"Financial management is the activity concerned with planning, raising, controlling and administering of funds used in the business." [Guthman and Dougal]*
- *"Financial management is that area of business management devoted to a judicious use of capital and a careful selection of source of capital in order to enable a spending unit to move in the direction of reaching its goals." [J.F.Brandley]*
- *"Financial management is the operational activity of a business that is responsible for obtaining and effectively utilizing the funds necessary for efficient operations."[Massie]*

NATURE, SIGNIFICANCE AND SCOPE OF FINANCIAL MANAGEMENT

For carrying on business we need resources which are pooled in terms of money. It is used for obtaining physical resources, carrying out productive activities and business operations, affect sales and pay compensation to suppliers of resources ? physical as well as monetary. Hence financial management is considered as an organic function of a business and has rightly become an important one.

Some theories on Financial Management- A group of experts says that Financial Management is simply the task of providing funds needed by the business or enterprise on terms that are most favourable in the light of its objectives. The approach, thus, is concerned almost exclusively with the procurement of funds and could be widened to include instruments, institutions and practices through which to raise funds. It also covers the legal and accounting relationship between a company and its sources of funds. Financial Management is certainly broader than procurement of funds; there are other functions and decisions too.

Other set of experts assume that finance is concerned with cash. Since every business transaction involves cash directly or indirectly, finance may be assumed to be concerned with everything that takes place in the conduct of a business. Hence, it is broader term.

The third set of people whose point of view has been widely accepted considers Financial Management as procurement of funds and their effective utilisations in the business; though there are other organisations like schools, associations, government agencies etc., where funds are procured and used.

Financial Management has not only to see that funds can be raised for installing plant and machinery at a cost; but it has also to see that additional profits adequately compensate for the costs and risks borne by the business while setting up the project.

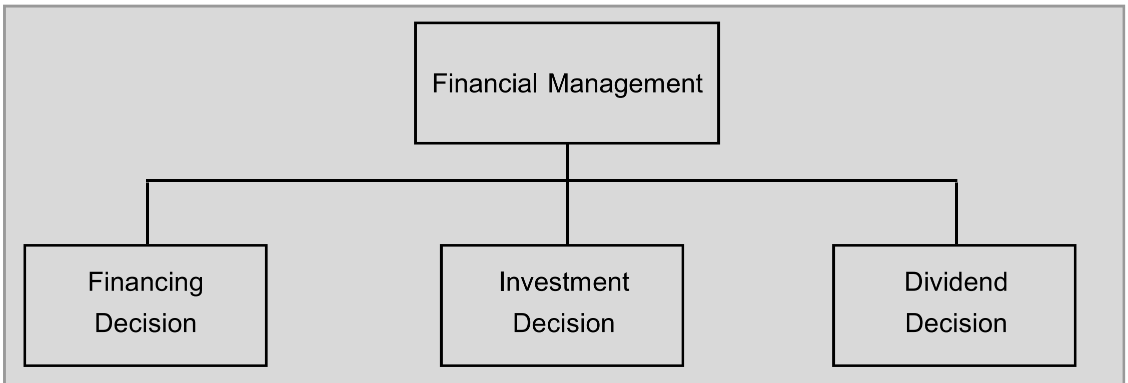
Thus from the point of view of a corporate unit, financial management is related not only to 'fund-raising' but encompasses wider perspective of managing the finances for the company efficiently.

In the developed state of a capital market, raising funds is not a problem; the real problem is to put the capital resources to efficient use through effective financial planning, financial organisation and financial control and to deal with tasks like ensuring the availability of funds, allocating them for different uses, managing them, investing funds, controlling costs, forecasting financial requirements, doing profit planning and estimating rate of return on investment and assessment of working capital etc.

Scope of Financial Management

Financial Management, to be more precise, is, thus concerned with investment, financing and dividend decisions in relation to objectives of the company. Such decisions have to take care of the interests of the shareholders. They are upheld by maximisation of shareholders' wealth which depends upon increase in the net worth ? capital invested in the business plus ploughed back profits for growth and prosperity of the company. It is for such reasons that the market is prepared to pay a lower or higher price for the shares of some company or the other.

The overriding role and scope of financial management can be explained by the following diagram:



Scope of Financial Mnagement

(1) Financing Decision comprises of a) Financial Planning and b) Capital Structure Decision.

(2) Investment Decision comprises of a) Fixed Capital Management and b) Working Capital Management.

(3) Dividend Decision comprises of a) Dividend Payment Policy Decision and b) Decision for Ploughing back or Retention of Surplus/ Profit.

Therefore, nature of Financial Management can be judged by the study of the nature of investment decisions, nature of financing decisions and the nature of dividend decisions.

CORE FINANCIAL MANAGEMENT DECISIONS

We have seen above that financial management is decision oriented. Managers in quest of minimizing cost of raising finance and deploying in most profitable manner take the following core decisions.

(i) *Investment Decisions or Investment of Funds:* Investment decision means deciding the quantum of investment out of available finance on long term basis as well as on short-term basis. Long-term investment decision also known as Capital Budgeting, means committing finance on long-term basis, i.e. , in fixed assets. It consists decisions like investing in land and building, acquiring new plant and machinery or replacing or modernizing the old machines, etc. These decisions once made cannot be reversed. Quality of capital budgeting decision decides the financial pursuits and performance of any business. Short-term investment decision also known as Working Capital Management means committing finance on short-term basis, i.e. , in current assets. It involves deciding the investment of fund in inventory, cash, bank balance and short-term investment. It directly affects liquidity as well as profitability of the business.

(ii) *Financing Decisions or Sources of Fund:* Financing decisions relate to raising finance from long-term as well short-term sources. Decisions for raising funds from long-term sources are called Capital Structure Decision. Decisions for raising funds from short-term sources come under *Working capital management*.

Financing decisions comprises two decisions, viz., i) Financial Planning; and ii) Capital structure decision.

Financial planning relates to estimating the sources and application of funds. Capital structure decisions involve identifying sources to raise funds. It also includes deciding whether to raise funds from external sources like issue of shares, debentures, bonds, borrowing from banks and financial institutions or to raise them from internal sources like retained earnings. Each source of finance has its cost. Therefore, cost of finance has to be determined before opting it.

(iii) *Dividend Decision or Distribution of Profits:* A part of profits after payment of tax is appropriated for reinvestment in business as retained profits and a part is distributed as dividend to shareholders. While shareholders may demand higher dividend, management may be tempted to retain higher profits to meet business needs. Choice of how much profits be retained and how much be distributed is therefore a complex managerial decision.

Financial Planning

Financial planning is one of the decisions comprised in financial decision. Financial planning means pre-estimating financial needs of an organization to ensure availability of adequate finance. Financial planning implies that the organization is neither flush of finance, i.e., funds remain unutilized nor there is shortage resulting in disruption of business operations. If the funds are excess, it may add on financing cost. If the funds are insufficient, the organization may fail to honour its commitments like timely payment to creditors, loans, interest, salary and other expenses. Financial planning therefore ensures right amount of finance at right time. Its objective is to plan and ensure availability of funds as and when demanded. It foretells how much funds shall be needed and when, how much shall be available and when and surplus or deficiency, if any.

Definitions of Financial Planning :

- “Financial Planning consists of capitalization, capital structure and policies required for proper utilization and administration of capital.” {Gersternberg}
- “Financial planning refers to estimating the amount of capital and determining its composition. It is concerned with the preparation of plans for the procurement, investment and administration of fund.”
- “Financial planning is the process of determining the objectives, policies, procedures, programmes and budgets to deal with financial activities of an enterprise.”

Thus, financial planning is the managerial activity that estimates capital requirements, decides and designs capital structure to exercise effective financial control.

MARKETING MANAGEMENT

Concept of Market – Market means the mechanism through which products and services are sold, exchanged and transferred. Market comprises of buyers, sellers, middlemen and all those concerned with sale and purchase of goods. The concept of market is viewed differently on the basis of place, area and demand, etc.

Definition of Traditional Concept of Marketing- "Marketing may be defined as the performance of business activities that directs the flow of goods and services through producers to consumers."

American Marketing Association

Definition of Modern Concept of Marketing- "Marketing is the process of discovering and translating consumer needs and wants into products and services and in turn making it possible for more and more of these products and services."

H.L. Hansen

Marketing is defined as the process of determining the needs and wants of consumers and being able to deliver products that satisfy those needs and wants. Marketing includes all the activities necessary to move a product from the producer to the consumer.

Marketing starts with marketing research, a learning process in which marketers get to know everything about the needs and wants of consumers, and it ends when somebody buys something.

Difference between Marketing and Selling

Marketing and Selling are not synonymous. Selling is a narrow concept which involves transfer of goods or services from producers to consumers. Whereas marketing is a wide concept which emphasizes identifying consumers needs and providing want satisfying products or services. The difference between the two can be explained as follows:

Basis	Selling	Marketing
Focus	It focuses on producers	It focuses on customers.
Supremacy	Producer is important.	Customer is supreme.
Demand	It assumes demand for products.	Demand generated for products needed by customers.
Motive	Profit is sole motive.	Profits are generated by customer satisfaction.
Process	It involves exchange of goods for valuable consideration.	It involves identifying and satisfying customer needs.
Scope	It is concerned with flow of goods to customers.	It is concerned with all activities which facilitate flow of goods to customers.
Emphasis	Product disposal or sale is emphasized.	Product identification and development to satisfy customers is emphasized.
Approach	It involves fragmented approach to sell all that is produced.	It involves integrated approach to identify and satisfy customer needs.
Law	Caveat emptor, let the buyer beware applies.	Caveat vendor, let the seller beware is followed.
Perspective	Selling has a short-term perspective with profit maximization.	Marketing has a long-term perspective with emphasis on customer creation, satisfaction, growth and stability.

Marketing Mix

In marketing , on the one side is the marketeer or the firm and on the other the market or the customers. The firm looks for transactions with the customers. It seeks to convert potential exchanges in to a reality. But in order to achieve this objective the firm must develop the product or service, inform customers about it, make it available, and determine its price. All these activities signify that the marketeer has to put together all the tools at his disposal in a combination so that his objective of sucessfully making a sale is realised.

Marketing mix refers to the ingredients or the tools or the variable, which the marketeer mixes in order to interact with a particular market.

Kotler defines Marketing Mix as “set of marketing tools that the firm uses to pursue its marketing objectives in the target market”.

Culliton conceived of marketeer as the ‘mixer of ingredients’.

William J.Stanton defines Marketiing Mix is the combination of four inputs which constitute the core of a company’s marketing system, i.e. , the product, the price structure, the promotional activities and the distribution system.

In one of the very early efforts to identify what in fact a marketeer mixes or assembles, Borden arrived at a list of marketing mix elements. Borden’s marketing mix included the following ingredients or elements:

(i) *Product Planning:* It included the policies and procedures relating to product line, quality, market, new product design and development.

(ii) *Pricing:* It included policies and procedures pertaining to price level, margins, pricing policy.

(iii) *Branding:* It included issues like trade marks, branding policy.

(iv) *Channels of Distribution:* It included policies related to personal selling, extent of reliance to personal sales efforts in retail or wholesale trade.

(v) *Advertising:* It included policies and procedures relating to budget, copy, product image and corporate image.

(vi) *Promotion:* It included issues like like burden to place on special selling plans, devises to be used for consumer promotions.

(vii) *Packaging:* It is included policies related with label and package.

(viii) *Displays:* It included policies pertaining to methods to employ for securing displays and burden to be placed on displays for securing sale.

(ix) *Servicing:* It included how service will be provided.

(x) *Physical Handling:* It included policies relating to transportation, warehousing and inventories.

Functions of Marketing

The functions of marketing are embodied in the aggregate of economic activities related to the transfer of property right, selling and buying, the transport and storage of goods, distribution, packaging, financing and procurement.

All these areas involve numerous marketing actions that are distinguished between general and specific functions.

The **general functions** of marketing are:

(i) *Market and Consumer Research:* This is the main function of all marketing activities. This function implies obtaining the information about the current market situation and future perspectives. This is the foundation of all decisions: formulating the strategy, designing a new product or service, extension to a new market, targeting a specific market.

(ii) *Permanent Adaptation:* to the requirements of social and economic environment. This implies the employment of all resources in order to operatively accommodate to the market demands. A company's adaptability can be measured by comparing the dynamics of the supply it is providing to the dimension, structure and level of demand. It depends on the capacity of the management to use the resources effectively.

(iii) *Full Satisfaction of Demand:* This is the objective of any company that aims for a rewarding economic activity. As a company manages to accomplish better the market requirements, its chances to gain profit, increase its turnover and surpass its competitors, rise.

(iv) *Maximizing of Economic Efficiency:* It assumes the optimization of all economic processes (production, transportation, storage, distribution) so that the profitability is increasing.

Marketing involves more than its functions. It has certain principles of organizing the company's activity:

(i) Market knowledge: The customer must be helped to make a choice. For this reason, various information from the market need to be collected and analyzed. Information about: the structure and dynamics of demand, tastes and preferences of consumers.

(ii) The company needs to produce what it can sell, not to sell what it can produce.

(iii) Anticipation of consumer preferences: The market needs to be studied and future trends forecasted.

(iv) Marketing for the company, not company for marketing. All resources need to be invested in the business and the staff needs to be motivated to adhere to the company's general objective.

Achievement of these principles guides the company to attain the final objective and has a long term perspective of efficient activities.

HUMAN RESOURCE

Human resource (or personnel) management, in the sense of getting things done through people. It's an essential part of every manager's responsibilities, but many organizations find it advantageous to establish a specialist division to provide an expert service dedicated to ensuring that the human resource function is performed efficiently.

"People are our most valuable asset" is a cliché which no member of any senior management team would disagree with. Yet, the reality for many organizations is that their people remain

– under valued
– under trained
– under utilized
– poorly motivated, and consequently
– perform well below their true capability.

The rate of change facing organizations has never been greater and organizations must absorb and manage change at a much faster rate than in the past. In order to implement a successful business strategy to face this challenge, organizations, large or small, must ensure that they have the right people capable of delivering the strategy.

The market place for talented, skilled people is competitive and expensive. Taking on new staff can be disruptive to existing employees. Also, it takes time to develop 'cultural awareness', product/ process/ organization knowledge and experience for new staff members.

As organizations vary in size, aims, functions, complexity, construction, the physical nature of their product, and appeal as employers, so do the contributions of human resource management. But, in most the ultimate aim of the function is to: "ensure that at all times the business is correctly staffed by the right number of people with the skills relevant to the business needs", that is, neither overstaffed nor understaffed in total or in respect of any one discipline or work grade.

Nature

Human Resource Management is a process of bringing people and organizations together so that the goals of each are met. The various features of HRM include:

- It is pervasive in nature as it is present in all enterprises.
- Its focus is on results rather than on rules.
- It tries to help employees develop their potential fully.
- It encourages employees to give their best to the organization.
- It is all about people at work, both as individuals and groups.
- It tries to put people on assigned jobs in order to produce good results.
- It helps an organization meet its goals in the future by providing for competent and well-motivated employees.
- It tries to build and maintain cordial relations between people working at various levels in the organization.
- It is a multidisciplinary activity, utilizing knowledge and inputs drawn from psychology, economics, etc.

Objectives of Human Resource Management

To help the organization reach its goals.

- To ensure effective utilization and maximum development of human resources.
- To ensure respect for human beings. To identify and satisfy the needs of individuals.
- To ensure reconciliation of individual goals with those of the organization.
- To achieve and maintain high morale among employees.
- To provide the organization with well-trained and well-motivated employees.
- To increase to the fullest the employee's job satisfaction and self-actualization.
- To develop and maintain a quality of work life.
- To be ethically and socially responsive to the needs of society.
- To develop overall personality of each employee in its multidimensional aspect.
- To enhance employee's capabilities to perform the present job.
- To equip the employees with precision and clarity in transaction of business.
- To inculcate the sense of team spirit, team work and inter-team collaboration.

Scope

The practice of HRM must be viewed through the prism of overall strategic goals for the organization instead of a standalone tint that takes a unit based or a micro approach. The idea here is to adopt a holistic perspective towards HRM that ensures that there are no piecemeal strategies and the HRM policy enmeshes itself fully with those of the organizational goals. For instance, if the training needs of the employees are simply met with perfunctory trainings on omnibus topics, the firm stands to lose not only from the time that the employees spend in training but also a loss of direction. Hence, the organization that takes its HRM policies seriously will ensure that training is based on focused and topical methods.

In conclusion, the practice of HRM needs to be integrated with the overall strategy to ensure effective use of people and provide better returns to the organizations in terms of ROI (Return on Investment) for every rupee spent on them. Unless the HRM practice is designed in this way, the firms stand to lose from not utilizing people fully. And this does not bode well for the success of the organization.

SERVICES

Legal

The legal department of a business handles legal issues which may come up in the course of business, ranging from drafting waiver forms for employees to handling lawsuits from angry customers. Many large companies have a legal department; smaller companies may choose to keep a lawyer or a staff of lawyers on retainer, ensuring that they have rapid access to legal knowledge when they need it. Customers often find themselves interacting with the legal department, especially when they file complaints or indicate that they believe a business is not being operated within the law.

Ideally, the legal department focuses only on tasks which require a trained lawyer; in other words, the legal department may look over a letter from an executive to ensure that it will not cause problems in the future, but they will not draft letters for members of the company, unless the letters pertain to legal matters.

One of the most important roles of the legal department is as legal advisers. Before marketing a new product, staff members will often discuss it with the legal department. Executives may talk with the legal staff about potential legal issues ranging from being accused of discrimination in hiring practices to sexual harassment. The legal department may also offer training and assistance with employee manuals to ensure that the company and its employees are kept up to date on workplace law, reducing the risk of potential suits.

The legal department will also become involved in customer complaints, ensuring that the responses to these complaints are drafted in a professional style which also covers the company's bases, legally. In the event that a company is sued, either from within or from the outside, the legal department will represent the company in the suit. It also handles the filing of patents and other legal documents with official agencies.

In a large, multi-national company, the legal department can be massive, approaching the size of a large law firm. The lawyers may come from different nations and have different training backgrounds, ensuring that every aspect of the company's business is covered, from a manufacturing plant in England to a bank in India. The staff members may also work together on deals, using their years of experience to vet proposals and documents, ensuring that the company is getting the best legal representation and advice possible.

Secretarial Functions

In business the secretarial functions performed by secretarial division and the company secretary is the officer dealing with such functions. The functions under the gamut of a company secretary are as under:

- Conducting Board Meetings as required under Companies Act involving issuance of notices, drafting agenda, recording minutes and preparing reports/corporate governance reports, etc. for listed companies, joint venture companies and other group companies.

- Conducting General Meeting of shareholders.
- Representing the organization for registration of company, change of names, shifting registered office, compounding offence, etc.
- Liaising and managing procedural formalities pertaining to re-structuring, Change of Name, Shifting of Registered Office etc.

Accounting

Accounting is the function of business that gathers data and information from all the different aspects of the business. The list of accounting functions are discussed as under:

(i) *Record Keeping Function:* The primary function of accounting is to keep a systematic record of financial transaction - journalisation, posting and preparation of final statements. The purpose of this function is to report regularly to the interested parties by means of financial statements.

(ii) *Protect Business Property:* The second function of accounting is to protect the property of business from unjustified and unwanted use. The accountant thus has to design such a system of accounting which protect its assets from an unjustified and unwanted use.

(iii) *Legal Requirement Function:* The third function of accounting is to devise such a system as will meet the legal requirements. Under the provision of law, a business man has to file various statements e.g., income tax returns, returns for sales tax purpose etc. Accounting system aims at fulfilling the requirements of law. Accounting is a base, with the help of which various returns, documents, statements etc., are prepared.

(iv) *Communicating the Results:* Accounting is the language of business. Various transactions are communicated through accounting. There are many parties - owners, creditors, government, employees etc, who are interested in knowing the results of the firm. The fourth function of accounting is to communicate the results to interested parties. The accounting shows a real and true position of the firm of the business.

Administration

Administration is the department that makes sure all of the office work is completed and also make sure all the paper work can be accessed easily if necessary and sent to any people that need it, it also tries to make the business operate as efficiently as possible. The department also controls most external communications. The administration department may also have to supply security for the premises.

The administration of a business consists of the performance or management of business operations and thus the making or implementing of a major decision. Administration can be defined as the universal process of organizing people and resources efficiently so as to direct activities toward common goals and objectives.

The Administrative Functions include:

- Administration of the department's human resource functions.
- Initiatives to foster regional economic development.
- Methods to create more effective plans.
- Oversight of inter and intra governmental affairs by the department.
- Programs to enhance the region's renewable/reusable resources and open space/natural resources.

Information and Communication Technology Function

The information and communication technology department will try and enable the business to benefit from implementing modern technology into the workspace. A good ICT department will increase the efficiency of a business and also by doing this increases the profits made by the business.

Many times this concerns the improvement of business processes as well as making them more cost effective. In other cases the purpose was to reach new customers or to bring new products or services to market.

It will be clear that such initiatives cause many changes in working procedures and in employee tasks. New web-based information systems have to be developed, and future plans for the information function as well as for the company as a whole have to be established.

All this is covered by ICT, innovating but also implementing changes.

LESSON ROUND UP

– Business Functions: Business function is a process or operation that is performed routinely to carry out a part of the mission of an organization. Business process may involve division of labor between multiple persons and/or technologies.

– A Business Function is a concept used in the Organisation Architecture domain and represents what work is done by that organisation, organisation unit or business role.

– Strategy: Strategy is the direction and scope of an organisation over the long-term: which achieves advantage for the organisation through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfill stakeholder expectations.

  - Planning: This step involves mapping out exactly how to achieve a particular goal. These necessary steps are developed into a plan. When the plan is in place, the manager can follow it to accomplish the goal of improving company sales
  - Budgetary control: A widely used device for managerial control is the budget. In this technique certain standards for performance are laid down. These standards are used to monitor, measure and regulate the actual performance.
  - R&D: involves establishing new applications, interpreting new findings, and making discoveries that can be commercialized are of interest to business managers.
  - Location of Business: The most important consideration for a start-up is the cost of the business location
  - Decision Making: produces a final choice. It might be regarded as a problem solving activity which is terminated when a satisfactory solution is reached.
  - Government Policy: are often ignored by businesses while starting up. These policies covers a wide range of legislative restrictions, regulations etc.

– Supply Chain Management: is the oversight of materials, information, and finances as they move in a process from supplier to manufacturer to wholesaler to retailer to consumer.

– Supply chain management flows can be divided into four main flows:

  - Product Flow
  - Information Flow
  - Finances Flow

- Finance: is the lifeblood of an organization; representing long-term and short-term requirements of an organization. It is a science of money that by its principles and methods explains how to acquire, administer and control finance. Financial management is concerned with optimal procurement as well as the usage of finance.
- Marketing Management: is defined as the process of determining the needs and wants of consumers and being able to deliver products that satisfy those needs and wants.
- Human Resource: is the resource for getting things done through people.
- Services: Various services involved in organisation are:
  - Legal
  - Secretarial
  - Accounting
  - Administration
  - Information and Communication Technology

GLOSSARY

Business Functions	A process or operation that is performed routinely to carry out a part of the mission of an organization. Function (such as production and sales) without which a firm cannot operate or remain viable.
Strategy	A method or plan chosen to bring about a desired future, such as achievement of a goal or solution to a problem.
Budget	One of the most important administrative tools that is an estimate of costs, revenues, and resources over a specified period, reflecting a reading of future financial conditions and goals.
Budgetary Control	Methodical control of an organization's operations through establishment of standards and targets regarding income and expenditure, and a continuous monitoring and adjustment of performance against them.
R&D	Systematic activity combining both basic and applied research, and aimed at discovering solutions to problems or creating new goods and knowledge.
Financial Decision	A judgment made regarding the method of raising funds that will be used to make acquisitions; it is based on an entity’s ability to issue and service debt and equity securities.
Investment Decision	A decision as to how, when, where and how much capital will be spent on investment opportunities. The decision often follows research to determine costs and returns for each option.
Dividend Decision	A decision determining the division of earnings between payments to shareholders and retained earnings.

Marketing Mix	A planned mix of the controllable elements of a product's marketing plan commonly termed as 4Ps: product, price, place, and promotion. These four elements are adjusted until the right combination is found that serves the needs of the product's customers, while generating optimum income.

SELF-TEST QUESTIONS

1. Explain the strategies adopted by businesses for effective functioning.
2. What are various types of strategies?
3. Give the importance of supply chain management.
4. How is financial management a significant function of business organisation?
5. Explian the significance of location decisions.
6. Elaborate 4Ps of marketing mix.
7. Distinguish between:
   (i) Selling and marketing
   (ii) Planning and Budgetary Control

Suggested Readings

(1) Business Organisation and Management by C. B. Gupta, Mayur Paperbacks.

(1) K. Aswathappa- Essentials of Business Environment, Himalaya Publishing House

PART B
BUSINESS LAWS

LESSONS

6.	Introduction to Law
7.	Elements of Company Law-I
8.	Elements of Company Law-II
9.	Indian Partnership Act, 1932
10.	Indian Contract Act, 1872
11.	Sale of Goods Act, 1930
12.	Negotiable Instruments Act, 1881

Laws are made to govern almost every walk of life. Business laws are evolved to govern and regulate trade and commerce. Hence, the term business laws or popularly known as mercantile laws can be defined as that branch of law, which comprises laws concerning trade, industry and commerce. Business laws are essential to understand the legal rules and aspects of business. Any form of business needs legal sanction. Therefore, it is imperative to understand the ways in which businesses can be organized. It is an ever-growing branch of law with the changing circumstances of trade and commerce. The business laws are foundation upon which the superstructure of modern business is built. It is common knowledge that in business transactions quite often promises are made at one time and the performance follows later. In such a situation, if either of the parties were free to go back on its promise without incurring any liability, there would be endless complications and it would be impossible to carry out activities of trade and commerce. Hence, a number of business laws are laid down to ensure smooth operations of business. In the context of business, only analyzing its environment would not suffice. This part deals with basic business laws which ensure uninterrupted functioning of operations.

Lesson 6
Introduction to Law

LESSON OUTLINE

- Nature of Law
- Meaning
- Significance of Law
- Relevance of Law to Modern Civilized Society
- Sources of Law
- Source of Indian Law
- Review Questions
- Legal Terminology and Maxims
- Understanding Citation of Cases
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

At the heart of the legal enterprise lies an important concept that is LAW. Owing to the societal inclination of interest in favour of businesses, it is essential to understand the basics of law. Without an understanding of the concept of law, the orientation and motivation towards attainment of justice is found missing. Moreover, without a comprehension of the cognitive and teleological foundations of the discipline, pedagogy becomes a mere teaching of the rules. The objective behind this is to present various statutes, cases, procedure, practices and customs as a systematic body of knowledge, and to be able to show the inter-connection between these various branches of law, procedure and principles.

The introduction to law is the very foundation to acquaint students with the law and its terminologies which will enable them to have a better understanding while dealing with statutes. But primarily, it inducts the student into realm of question concerning law so that he is able to live with their perplexity or complexity and driven to seek out answers for himself.

Law is the command of the sovereign, Law is an instrument to regulate human behaviour, Be it social life or business life.

Jack Welch

LAW – AN INTRODUCTION

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

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

- Natural
- Positivistic
- Historical
- Sociological
- Realistic

Natural School

Under this school fall most of the ancient definitions given by Roman and other ancient Jurists.

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

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

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

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

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

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

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

Vinogradoff described Law as "a set of rules imposed and enforced by society with regard to the attribution and exercise of power over persons and things."

Positivistic Definition of Law

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

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

Historical Definition of Law

Savigny's theory of law can be summarised as follows:

- That law is a matter of unconscious and organic growth. Therefore, law is found and not made.
- Law is not universal in its nature. Like language, it varies with people and age.
- Custom not only precedes legislation but it is superior to it. Law should always conform to the popular consciousness.
- Legislation is the last stage of law making, and, therefore, the lawyer or the jurist is more important than the legislator.

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

Sociological Definition of Law

Duguit defines law as "essentially and exclusively as social fact."

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

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

Realist Definition of Law

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

From the above definitions, it follows that law is nothing but a mechanism of regulating the human conduct in society so that the harmonious co-operation of its members increases and thereby avoid the ruin by co-ordinating the divergent conflicting interests of individuals and of society which would, in its turn, enhance the potentialities and viability of the society as a whole.

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

- Law pre-supposes a State

– The State makes or authorizes to make, or recognizes or sanctions rules which are called law

– For the rules to be effective, there are sanctions behind them

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

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

Laws are made effective:

– by requiring damages to be paid for an injury due to disobedience

– by requiring one, in some instances, to complete an obligation he has failed to perform

– by preventing disobedience

– by administering some form of punishment

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

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

SIGNIFICANCE OF LAW

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

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

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

SOURCES OF INDIAN LAW

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

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

– Principle Sources of Indian Law

– Secondary Sources of Indian Law

(A) PRINCIPLE SOURCES OF INDIAN LAW

The principal sources of Indian law are:

– Customs or Customary Law

– Judicial Decisions or Precedents

– Statutes or Legislation

– Personal Law e.g., Hindu and Mohammedan Law, etc.

(i) Customs or Customary Law

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

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

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

Custom as a source of law has a very inferior place in the Mohammedan Law. However, customs which were not expressly disapproved by the Prophet were good laws. It was on the basis of such customs that Sunnis interpreted many provisions of the law, especially the law of divorce and inheritance. In India, many sects of Mohammedans are governed by local customary law.

Classification of Customs

The customs may be divided into two classes:

– Customs without sanction.

– Customs having sanction.

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

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

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

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

– Geographical Local Customs

– Personal Local Customs

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

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

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

– It must be shown that the convention is clearly established and it is fully known to the contracting parties. There is no fixed period for which a convention must have been observed before it is recognised as binding.

– Convention cannot alter the general law of the land.

– It must be reasonable.

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

Requisites of a Valid Custom

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

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

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

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

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

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

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

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

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

(ii) Judicial Decision or Precedents

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

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

The reason why a precedent is recognised is that a judicial decision is presumed to be correct. The practice of following precedents creates confidence in the minds of the litigants. Law becomes certain and known and that in itself is a great advantage. Administration of justice becomes equitable and fair.

General Principles of Doctrine of Precedents

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

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

High Courts

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

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

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

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

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

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

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

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

Supreme Court

The expression 'all courts' used in Article 141 refers only to courts other than the Supreme Court. Thus, the Supreme Court is not bound by its own decisions. However, in practice, the Supreme Court has observed that the earlier decisions of the Court cannot be departed from unless there are extraordinary or special reasons to do so (AIR 1976 SC 410). If the earlier decision is found erroneous and is thus detrimental to the general welfare of the public, the Supreme Court will not hesitate in departing from it.

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

Kinds of Precedents

Precedents may be classified as:

– Declaratory and Original Precedents

– Persuasive Precedents

– Absolutely Authoritative Precedents

– Conditionally Authoritative Precedents.

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

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

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

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

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

(iv) *Conditionally Authoritative Precedents:* A conditionally authoritative precedent is one which, though ordinarily binding on the court before which it is cited, is liable to be disregarded in certain circumstances.

The court is entitled to disregard a decision if it is a wrong one, i.e., contrary to law and reason. In India, for instance, the decision of a single Judge of the High Court is absolutely authoritative so far as subordinate judiciary is concerned, but it is only conditionally authoritative when cited before a Division Bench of the same High Court.

Doctrine of Stare Decisis

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

Ratio Decidendi

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

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

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

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

Obiter Dicta

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

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

(iii) Statutes or Legislation

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

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

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

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

(iv) Personal Law

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

(a) The Shruti which includes four Vedas.

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

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

The personal law of Mohammedans is to be found in

(a) The holy Koran.

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

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

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

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

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

(B) SECONDARY SOURCE OF INDIAN LAW

(i) Justice, Equity and Good Conscience

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

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

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

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

(ii) Sources of English Law

The chief sources of English law are:

– Common Law

– Law Merchant

– Principle of Equity

– Statute Law.

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

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

(iii) *Principle of Equity:* Equity is a body of rules, the primary source of which was neither custom nor written law, but the imperative dictates of conscience and which had been set forth and developed in the Courts of Chancery. The procedure of Common Law Courts was very technical and dilatory. Action at Common Law could be commenced by first obtaining a writ or a process. The writs were limited in number and unless a person was able to bring his case within one of those writs, no action could lie at Common Law.

In some cases, there was no remedy or inadequate remedy at Common Law. The King is considered as the fountain head of justice; when people were dissatisfied or aggrieved with the decision of the Common Law Court, they could always file a mercy petition with the King-in-Council. The King would refer these petitions to his Chancellor. The Chancellor, who was usually a Bishop, would dispose of these petitions not according to the rigid letter of the law but according to his own dictates of commonsense, natural justice and good conscience. The law so administered by the Chancellor came to be known as 'Equity' and such courts as 'Equity Courts'. These 'Equity Courts' acted on number of maxims e.g.,

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

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

Some of the important principles and remedies developed by Equity Courts are recognition of the right of beneficiary to trust property, remedy of specific performance of contracts, equity of redemption in case of mortgages etc.

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

Mercantile or Commercial Law

There are many branches of law; viz.,

– Constitutional Law

– Administrative Law

– Criminal Law

– Civil Law

– Mercantile or Commercial Law.

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

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

Sources of Mercantile Law

The following are the main sources of Mercantile Law:

– Law Merchant

- Statute Law
- Common Law
- Principles of Equity.

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

Mercantile Law in India

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

Sources of Indian Mercantile Law

The main sources of Indian Mercantile Law are:

- English Mercantile Law
- Acts enacted by Indian Legislature
- Judicial Decisions
- Customs and Trade Usages.

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

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

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

(iv) *Customs and Trade Usages:* Most of the Indian Law has been codified. But even then, it has not altogether done away with customs and usages. Many Indian statutes make specific provisions to the effect that the rules of law laid down in a particular Act are subject to any special custom or usages of trade. For example, Section 1 of the Indian Contract Act, 1872, lays down that, "Nothing herein contained shall effect the provisions of any Statute, Act or Regulation not hereby expressly repealed, nor any usage or custom of trade, nor any incident of any contract, not inconsistent with the provisions of this Act". Similarly Section 1 of the Negotiable Instruments Act, 1881, lays down that, "nothing herein contained... affects any local usage relating to any instrument in any oriental language". It may be noted that the whole law relating to Hundis and the Kachhi and Pakki Adat Systems of Agency is based on custom and usage of trade as recognised and given legal effect to by courts of law in India.

REVIEW QUESTIONS

Fill in the blanks :

1. Customs .... sanction are those customs which are enforced by the state.

State True or False:

2. A custom to be valid be proved to be immemorial but may not be ancient.

3. The principle of judicial decision which is only authoritative is known as ratio decidendi.

Answers: 1. having 2. False 3. True

LEGAL TERMINOLOGY AND MAXIMS

A legal maxim is an established principle or proposition. The Latin term which were used as the language for law and courts, are presently in use in law. A list of important legal maxims with meaning is being given hereunder:

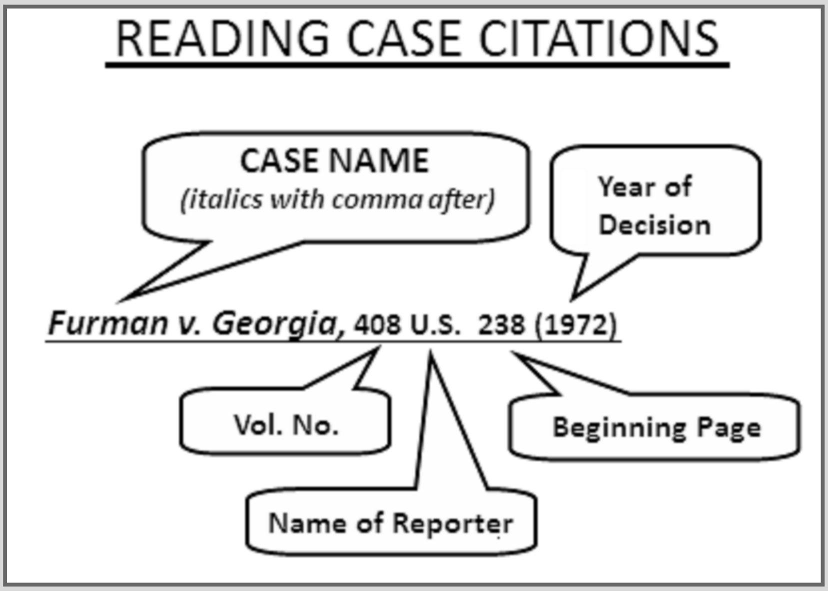
Term/Phrase	Meaning
ab initio	From the beginning.
ad hoc	Not intended to be able to be adapted to other purposes.
ad idem	To the same thing.
ad infinitum	To infinity.
ad valorem	According to value.
alter ego	A second identity living within a person.
amicus curiae	Friend of the court.
audi alteram partem	Hear the other side.
bona fide	In good faith.
de facto	In fact.
de jure	In law.
de novo	A new.
dehors	Outside of.

ex gratia	As a matter of grace or favour.
ex officio	By virtue of an office.
ex parte	Expression used to signify something done or said by one person not in the presence of his opponent.
fait accompli	An accomplished act.
ictus reus	Guilty act.
in personam	Against the person.
in rem	An act/proceeding done or directed with reference to no specific person or with reference to all whom it might concern.
inter alia	Amongst other things.
inter vivos	Between living persons.
intestate	A person is deemed to die intestate in respect of property of which he or she has not made a testamentary disposition (“will”) capable of taking effect.
intra vires	Within the powers.
ipso facto	By the mere fact.
ipso jure	By the law itself.
lis pendens	A pending suit.
locus standi	Signifies a right to be heard.
mens rea	A guilty mind.
mesne profits	Intermediate profits, the profits which a person in wrongful possession of the property actually received or might with ordinary diligence have received therefrom together with interest on such profits excluding the profits due to improvement made by the person in wrongful possession.
modus operandi	Mode of operating; the way in which a thing, cause etc. operates.
mutatis mutandis	With the necessary changes in points of detail, with such change as may be necessary.
obiter dictum	An opinion of law not necessary to the decision. An expression of opinion (formed) by a judge on a question immaterial to the ratio decidendi, and unnecessary for the decision of the particular case. It is no way binding on any court, but may receive attention as being an opinion of high authority.
pendente lite	During litigation.
quid pro quo	The giving of one thing of value for another thing of value; one for the other; thing given as compensation.
ratio decidendi	Reasons for deciding, the grounds of decision.

res integra	An untouched matter; a point without a precedent; a case of novel impression.
res judicata	A case or suit already decided.
rule nisi	A rule to show cause why a party should not do a certain act, or why the object of the rule should not be enforced.
sine die	Without day.
sine qua non	An indispensable requisite.
stare decisis	To stand by things decided; to abide by precedents where the same points come again in litigation.
status quo	Existing condition.
sub judice	Before a judge or court, pending decision of a competent count.
ultra vires	Beyond one's powers.

UNDERSTANDING CASE CITATION

Knowing how to read and write case citations is an important skill for everyone studying law. The figure below and the comments that follow may help with your understanding of the basic elements.



Reading Case Citation

Above are the parts of a standard case citation. The citation tells us that a case called Furman versus Georgia was decided in 1972 and can be found in Volume 408 of the United States Reports, starting on page 238.

Some Variations

- When using a direct quote from the case, it is important to provide the specific page on which that quote is found. In that case, the citation would have the page added as follows:

  Furman v. *Georgia*, 408 U.S. 238, 240 (1972)

OR

Furman v. *Georgia*, 408 U.S. at 240 (1972)

- Because federal appeals courts (circuit courts) are found in one of twelve different districts, the specific district is typically added as follows:

  Cooper v. *Pate*, 382 F.2d 443 (7th Cir. 1967)

- Ninety-four federal district courts are spread throughout the country (there is at least one in every state and the more populated states have as many as four). The specific district should be identified :

  Howard v. *United States*, 864 F.Supp. 1019 (D. Colo. 1994)

Case Name

There are typically two names for a case. Usually, the first name identifies who is bringing the court action and the second name is the person against whom action is being brought. In a criminal law case action is almost always brought by the state (e.g., People or State) against a person (e.g., Sunil) as in Nathu Ram Shukla v. State of Madhya Pradesh or Union of India v. Union Carbide.

However, the "defendant" may not always stay the same. In the Furman v. Georgia case, Furman was originally the defendant in a murder case being prosecuted in Georgia. However, Furman appealed his conviction and in doing so he became the person taking action against the state.

Year

This is the year in which the decision was delivered by the court. It may not be (and in appellate cases, probably isn't) the year in which the case was heard.

Name of Reporter

A 'reporter' is a multi-volume publication where court decisions are found. The full name and abbreviations for the reporters you are most likely to encounter as undergraduates are:

Full Name	Official Abbreviation	Type of Case Reported
All India Reports	AIR	Important decision from Supreme Court and High Courts.
Supreme Court Cases	SCC	Indian Supreme Court.
Company Law Journal	CLJ	Important decisions relating to company law matters.
Income Tax Report	ITR	Important decisions relating to income tax matters.
Labour Reports	LR	Important decisions relating to Labour law matters.

LESSON ROUND UP

- The nature and meaning of law has been described by various jurists. However, there is no unanimity of opinion regarding the true nature and meaning of law. The various definitions of law propounded by legal theorists serve to emphasize the different facets of law and build up a complete and rounded picture of the concept of law.
- The various definitions into five broad classes:
  - Natural: The law consists of rules recognised and acted on by the courts of Justice.
  - Positivistic: Law is the aggregate of rules set by man as politically superior, or sovereign, to men as political subject.
  - Historical: Law is found and not made.
  - Sociological: Essentially and exclusively as social fact.
  - Realistic: Law is a statement of the circumstances in which public force will be brought to bear upon through courts.
- The modern Indian law as administered in courts is derived from various sources and these sources fall under the following two heads:
  - Principal Sources of Indian Law
  - Secondary Sources of Indian Law
- The principal sources of Indian law are:
  - Customs or Customary Law
  - Judicial Decisions or Precedents
  - Statutes or Legislation
  - Personal Law
- Custom is the most ancient of all the sources of law and has held the most important place in the past, though its importance is now diminishing with the growth of legislation and precedent.
- The guidance or authority of past decisions of the courts for future cases or only such decisions which lay down some new rule or principle are called judicial precedents.
- The *doctrine of stare decisis* means "adhere to the decision and do not unsettle things which are established". It is a useful doctrine intended to bring about certainty and uniformity in the law.
- Legislation is that source of law which consists in the declaration or promulgation of legal rules by an authority duly empowered by the Constitution in that behalf. It is sometimes called *Jus scriptum* (written law) as contrasted with the customary law or *jus non-scriptum* (unwritten law).
- The courts are required to apply the personal law of the parties where the point at issue is not covered by any statutory law or custom.
- Secondary Source of Indian Law
  - Justice, Equity and Good Conscience
  - Sources of English Law

GLOSSARY

Customary Law	Traditional common rule or practice that has become an intrinsic part of the accepted and expected conduct in a community, profession, or trade and is treated as a legal requirement.
Statutes	An act of a legislature that declares, proscribes, or commands something; a specific law, expressed in writing.
Doctrine of Stare Decisis	The policy of courts to abide by or adhere to principles established by decisions in earlier cases.
Ratio Decidendi	The legal principle upon which the decision in a specific case is founded. The ratio decidendi is also known as the rationale for a decision.
Obiter Dicta	An opinion voiced by a judge that has only incidental bearing on the case in question and is therefore not binding. Remarks of a judge which are not necessary to reaching a decision, but are made as comments, illustrations or thoughts.

SELF-TEST QUESTIONS

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

Suggested Readings

(1) An introduction to Jurisprudence (Legal Theory) – B.N.M.P. Tripathi

(2) Introduction of Jurisprudence with Selected Texts – Dennis Lloyd

(3) Essential Business Law (Law and the legal System) – Peter Smith.

Lesson 7
Elements of Company Law-I

LESSON OUTLINE

– Introduction
– Company - Meaning and Characteristics
– Distinction with Other Forms of Business
– Advantages and Disadvantages of Incorporation
– Kinds of Companies
– Promotion and Incorporation of a Company
– Registration of Company
– Commencement of Business
– How does a company function
– Lesson Round Up
– Self-Test Questions

LEARNING OBJECTIVES

Industrialisation plays vital role in the development of the India. In the post independence era, industrial regulation is employed as a principle means in the strategy for attaining constitutional values. Companies are no doubt powerful instrument of development. Besides bringing returns and financial benefits to the capital and labour they help amelioration of the living conditions of masses. In a developing society like India, vast varieties of consumer goods are manufactured or produced and different kinds of public utility services are generated both for general welfare and consumption purposes. Obviously, it is beyond the capacity of one or a few entrepreneurs to engage into such activities. Because the problem of raising large capital needed for such enterprises, there is a looming danger of market risks.

Hence, taking sources to the device of incorporation is the only efficacious way to surmount all these hurdles.

Corporation: An ingenious device for obtaining profit without individual responsibility.

Ambrose Bierce

A. COMPANY — MEANING AND CHARACTERISTICS

COMPANY – IT'S MEANING

The word "company" is derived from the Latin (Com = with or together; panis = bread), and originally referred to an association of persons who took their meals together. It may be assumed, since human nature does not change that in the leisurely past no less than in the speedy present, merchants took advantage of festive gatherings, to discuss business matters. Now-a-days, the business matters have become most complicated and cannot be discussed at length on festive gatherings. Therefore, the word "company" has assumed great importance as it denotes a joint stock enterprise in which the capital is contributed by a large number of people. Thus, in popular parlance, company denotes an association of like minded persons formed for the purpose of carrying on same business or undertaking. Though an association may be brought into existence for multifarious purposes, in Company Law it figures predominantly as a business association with a large and fluctuating membership formed for making a gain as profit. There may also be non-profit trading concerns like a club or a society. In *Smith* v. *Anderson,* (1880) 15 Ch.D.247, it was observed that "a company, in broad sense, may mean an association of individuals formed for some purpose".

A company may be an incorporated company or a "corporation" or an unincorporated company. An incorporated company is a separate person distinct from the individuals constituting it whereas an unincorporated company, such as a partnership, is mere collection or aggregation of individuals. Therefore, unlike a partnership firm, a company is a corporate body and a legal person having status and personality distinct and separate from that of the members constituting it.

It is called a body corporate because the persons composing it are made into one body by incorporating it according to the law, and clothing it with legal personality, and, so turn it into a corporation (The word "corporation" is derived from the Latin term "corpus" which means "body"). Accordingly, "corporation" is a legal person created by the process other than natural birth. It is, for this reason, sometimes called artificial person. This corporate being is capable of enjoying many of the rights and incurring many of the liabilities of a natural person - a human being.

The incorporated company owes its existence to a special Act of Parliament or to Companies Law. The public corporations like Life Insurance Corporation of India and Damodar Valley Corporation have been brought into existence through special Acts of Parliament whereas companies like Tata Steel Ltd., Reliance Industries Ltd. have been formed under the Companies Act, 1956 which is being replaced by Companies Act, 2013. The trading partnership which is governed by Partnership Act is the most apt example of an unincorporated association.

In the legal sense, a company is an association of both natural and artificial persons incorporated under the existing law of a country. As per section 2(20) of the Companies Act, 2013 "company" means a company incorporated under Companies Act, 2013 or under any previous company law;" . In common law, a company is a "legal person" or "legal entity" separate from, and capable of surviving beyond the lives of, its members. However, an association formed not for profit acquires a corporate life and falls within the meaning of a company by reason of a licence under Section 8 of the Companies Act, 2013.

COMPANY – ITS CHARACTERISTICS

The main characteristics of a company are as follow:

Corporate Personality

By incorporation under the Act, the company is vested with a corporate personality quite distinct from individuals who are its members. Being a separate legal entity it bears its own name and acts under a corporate name. It has a seal of its own. Its assets are separate and distinct from those of its members. It is also a different 'person' from the members who compose it. As such it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual. Its members are its owners but they can be its creditors simultaneously as it has a separate legal entity. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The shareholders are not the agents of the company and so they cannot bind it by their acts. The company does not hold its property as an agent or trustee for its members and they cannot sue to enforce its rights, nor can they be sued in respect of its liabilities. The case of *Salomon* v. *Salomon and Co. Ltd.,* (1897) A.C. 22, has clearly established the principle that once a company has been validly constituted under the Companies Act it becomes a legal person distinct from its members and for this purpose it is immaterial whether any member has a large or small proportion of the shares, and whether he holds those shares beneficially or as a mere trustee. The facts of this case are as follows:

Salomon had, for some years, carried on a prosperous business as leather merchant and boot manufacturer. He formed a limited company consisting of himself, his wife, his daughter and his four sons as the shareholders, all of whom subscribed for 1 share each so that the actual cash paid as capital was £ 7. Salomon sold his business (which was perfectly solvent at that time), to the Company for the sum of £ 38,782. The company's nominal capital was £ 40,000 in £ 1 shares. In part payment of the purchase money for the business sold to the company, debentures of the amount of £ 10,000 secured by a floating charge on the company's assets were issued to Salomon, who also applied for and received an allotment of 20,000 £ 1 fully paid shares. The remaining amount of £ 8,782 was paid to Salomon in cash. Salomon was the managing director and two of his sons were other directors.

The company soon ran into difficulties and the debentureholders appointed a receiver and the company went into liquidation. The total assets of the company amounted to £6050, its liabilities were £10,000 secured by debentures, £8,000 owning to unsecured trade creditors, who claimed the whole of the company's assets, viz., £6,050, on the ground that, as the company was a mere 'alias' or agent for Salomon, they were entitled to payment of their debts in priority to debentures. They further pleaded that Salomon, as principal beneficiary, was ultimately responsible for the debts incurred by his agent or trustee on his behalf. The trial judge and the Appellate Court agreed with these contentions and decreed against Salomon. The House of Lords disagreeing with the lower Courts, repudiated these contentions and accepted the appeal and reversed the order of the Appellate Court. The House of Lords held that on registration, the company comes into existence and attains maturity on its birth. There is no period of minority, no interval of incapacity. It has its own existence or personality separate and distinct from its members and, as a result, a shareholder cannot be held liable for its acts even though he holds virtually the entire share capital. Thus, the case also established the legality of what is known as "one-man company". The case also recognised that subscribers do not have to be independent or strangers to one another. The case also recognised the principle of limited liability. It also established that a person can be at the same time a member, a creditor and an employee of the company, as well as its director.

Their Lordships observed:

> "When the memorandum is duly signed and registered, though there be only seven shares taken, the subscribers are a body corporate capable forthwith of exercising all the functions of an incorporated company. It is difficult to understand how a body corporate thus created by statute can lose its individuality by issuing the bulk of its capital to one person. The company is at law a different person altogether from the subscribers of the memorandum; and though it may be that after incorporation the business is precisely the same as before, the same persons are managers, and the same hands receive the profits, the company is not in law their agent or trustee."

Limited Liability

The company being a separate entity, leading its own business life, the members are not liable for its debts.

The liability of the members of a company is limited to the extent of the nominal value of the shares held by them. In no event can a shareholder be asked to pay anything more than the unpaid value of his shares. In the case of a company limited by guarantee, the members are liable only to the extent of the amount guaranteed by them and not beyond, and only when the company goes into liquidation.

Perpetual Succession

Members may come and members may go but the company goes on for ever. Variation in members or their identity does not affect the legal existence and identity of a company. It is a creation of law and can be dissolved only under the law.

Transferability of Shares

The capital of a company is divided into parts, called shares. The shares are said to be movable property and, subject to certain conditions, freely transferable, so that no shareholder is permanently or necessarily wedded to a company. The shares of joint stock companies are freely transferable. In the case of a private company, the Companies Act requires it to put certain restrictions on the transferability of shares. Every member owing fully paid-up shares is at liberty to dispose them off according to his choice but subject to the articles of the company. Any absolute restriction on the right to transfer shares is void.

Separate Property

As a corporate person, the company is entitled to own and hold property in its own name. No member can claim ownership of any item of the company's assets.

Common Seal

On incorporation, a company acquires legal entity with perpetual succession and a common seal. Since the company has no physical existence, it must act through its agents and all such contracts entered into by its agents must be under the seal of the company. The common seal of the company is of very great importance. It acts as the official signature of a company. The name of the company must be engraved on its common seal. A rubber stamp does not serve the purpose. A document not bearing common seal of the company is not authentic and has no legal force behind it.

Capacity to Sue and Be Sued

A company being a body corporate, can sue and be sued in its own name. All legal proceedings against the company are to be instituted in its own name. Similarly, the company may bring an action against anyone in its own name. In case of unincorporated association an action may have to be brought in the name of the members either individually or collectively.

Company as Distinguished from other Associations of Persons

Though there are a number of similarities between a limited company and other forms of associations, there are many dissimilarities. In both the cases individuals are the subjects, and trading is generally the object. In the following paragraphs a limited company is distinguished from a partnership firm, a Hindu Joint Family business, a club and a registered society.

Though there are a number of similarities between a limited company and other forms of associations, there are a great number of dissimilarities as well. In both the cases individuals are the subjects, and trading is generally the object. In the following paragraphs, a limited company is distinguished from a partnership firm, a Limited Liability Partnership, a Hindu Joint Family business and a registered society.

Distinction between Company and Partnership

The principal points of distinction between a company and a partnership firm, are as follows:

1. A company is a distinct legal person. A partnership firm is not distinct from the several persons who compose it.
2. In a partnership, the property of the firm is the property of the individuals comprising it. In a company, it belongs to the company and not to the individuals comprising it.
3. Creditors of a partnership firm are creditors of individual partners and a decree against the firm can be executed against the partners jointly and severally. The creditors of a company can proceed only against the company and not against its members.
4. Partners are the agents of the firm, but members of a company are not its agents. A partner can dispose of the property and incur liabilities as long as he acts in the course of the firm's business. A member of a company has no such power.
5. A partner cannot contract with his firm, whereas a member of a company can.
6. A partner cannot transfer his share and make the transferee a member of the firm without the consent of the other partners, whereas a company's share can ordinarily be transferred.
7. Restrictions on a partner's authority contained in the partnership contract do not bind outsiders; whereas such restrictions incorporated in the Articles are effective, because the public are bound to acquaint themselves with them.
8. A partner's liability is always unlimited whereas that of shareholder may be limited either by shares or a guarantee.
9. A company has perpetual succession, i.e. the death or insolvency of a shareholder or all of them does not affect the life of the company, whereas the death or insolvency of a partner dissolves the firm, unless otherwise provided.
10. A company may have any number of members except in the case of a private company which cannot have more than fifty members (excluding past and present employee members). In a public company there must not be less than seven persons and in a private company not less than two. Further, a new concept of one person company has been introduced which may be incorporated with only one person. On the other hand, a partnership firm cannot have more than 100 members .
11. A company is legally required to have its accounts audited annually by a chartered accountant, whereas the accounts of a firm are audited at the discretion of the partners.
12. A company, being a creation of law, can only be dissolved as laid down by law. A partnership firm, on the other hand, is the result of an agreement and can be dissolved at any time by agreement.

Distinction between company and Limited Liability Partnership (LLP)

LLP is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership. LLP can continue its existence irrespective of changes in partners. It is capable of entering into contracts and holding property in its own name. LLP is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP.

Further, no partner is liable on account of the independent or un-authorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct.

Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners or between the partners and the LLP as the case may be. The LLP, however, is not relieved of the liability for its other obligations as a separate entity.

Since LLP contains elements of both 'a corporate structure' as well as 'a partnership firm structure' LLP is called a hybrid between a company and a partnership.

LLP is a body corporate and a legal entity separate from its partners, having perpetual succession. LLP form is a form of business model which :(i) is organized and operates on the basis of an agreement.(ii) provides flexibility without imposing detailed legal and procedural requirements (iii) enables professional/technical expertise and initiative to combine with financial risk taking capacity in an innovative and efficient manner.

A basic difference between an LLP and a company lies in that the internal governance structure of a company is regulated by statute (i.e. Companies Act) whereas for an LLP it would be by a contractual agreement between partners.

The management-ownership divide inherent in a company is not there in a limited liability partnership. LLP have more flexibility as compared to a company. LLP have lesser compliance requirements as compared to a company.

Distinction between Company and Hindu Joint Family Business

1. A company consists of heterogeneous members, whereas a Hindu Undivided Family Business consists of homogenous members since it consists of members of the joint family itself.
2. In a Hindu Joint Family business the Karta (manager) has the sole authority to contract debts for the purpose of the business, other coparceners cannot do so. There is no such system in a company.
3. A person becomes a member of Joint Hindu Family business by virtue of birth. There is no provision to that effect in the company.
4. No registration is compulsory for carrying on business for gain by a Hindu Joint Family even if the number of members exceeds twenty [*Shyamlal Roy* v. *Madhusudan Roy*, AIR 1959 Cal. 380 (385)]. Registration of a company is compulsory.

Distinction between a Company and a Club

1. A company is a trading association. A club, on the other hand, is a non-trading association.
2. Registration of a company is compulsory. Registration of a club is not compulsory.

Distinction between a Company and a Corporation (i.e. Company *vis-à-vis* Body Corporate)

Generally speaking, an association of persons incorporated according to the relevant law and clothed with legal personality separate from the persons constituting it is known as a corporation. The word 'corporation' or words 'body corporate' is/are both used in the Companies Act, 2013.

Definition of the same which is reproduced below is contained in Clause (11) of Section 2 of the Act:

"Body corporate" or "corporation" includes a company incorporated outside India, but does not include—

(*i*) a co-operative society registered under any law relating to co-operative societies; and

(*ii*) any other body corporate (not being a company as defined in this Act),

which the Central Government may, by notification, specify in this behalf;

A society registered under the Societies Registration Act has been held by the Supreme Court in *Board of Trustees* v. *State of Delhi,* A.I.R. 1962 S.C. 458, not to come within the term 'body corporate' under the Companies

Act, though it is a legal person capable of holding property and becoming a member of a company.

Advantages of Incorporation

As compared to other types of business associations, an incorporated company has the following advantages:

A. *Corporate Personality:* Unlike a partnership firm, which has no existence apart from its members, a company is a distinct legal or juristic person independent of its members. Under the law, an incorporated company is a distinct entity, even the one-man company as discussed above in Salomon & Co. Ltd., case is different from its shareholders.

   As per section 9 of the Companies Act, 2013 from the date of incorporation mentioned in the certificate of incorporation, such subscribers to the memorandum and all other persons, as may, from time to time, become members of the company, shall be a body corporate by the name contained in the memorandum, capable of exercising all the functions of an incorporated company under the Act and having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name.

B. *Limited Liability:* The Companies Act provides that in the event of the company being wound-up, the members shall have liability to contribute to the assets of the company in accordance with the Act. In the case of companies limited by shares, no member is bound to contribute anything more than the nominal value of the shares held by him which remains unpaid. The privilege of limiting the liability is one of the principal advantages of doing business under the corporate form of organisation.

C. *Perpetual Succession:* As stated in Section 9 of the Companies Act, 2013 an incorporated company has perpetual succession. Notwithstanding any change in its members, the company will be the same entity with the same privileges and immunities, estate and possessions. The death or insolvency of individual members does not in any way, affect the corporate entity, its existence or continuity. The company shall continue to exist indefinitely till it is wound-up in accordance with the provisions of the Companies Act. "Members may come and members may go but the company can go on forever".

D. *Transferable Shares:* Section 44 of the Companies Act, 2013 provides the shares or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company. This encourages investment of funds in the shares, so that the members may encash them at any time. Thus, it provides liquidity to the investors as shares could be sold in the open market and in stock exchange. It also provides stability to the company.

E. *Separate Property:* A company as a legal entity is capable of owning its funds and other assets. "The property of the company is not the property of the shareholders, it is property of the company" [*Gramophone & Typewriter Co.* v. *Stanley,* (1906) 2 K.B. 856 at p. 869]. "The company is the real person in which all the property is vested, and by which it is controlled, managed and disposed of". In the eyes of law, even a member holding majority of shares or a managing director of a company is held liable for criminal mis-appropriation of the funds or property of the company, if he unauthorisedly takes it away and uses it for his personal purposes.

F. *Capacity to Sue:* As a juristic legal person, a company can sue in its name and be sued by others. The managing director and other directors are not liable to be sued for dues against a company.

G. *Flexibility and Autonomy:* The company has an autonomy and independence to form its own policies and implement them, subject to the general principles of law, equity and good conscience and in accordance with the provisions contained in the Companies Act, Memorandum and Articles of Association. The company form of management of business disassociates the "ownership" from the "control" of business, and helps promote professional management and efficiency. The Key Managerial Personnel can carry on the business activities with freedom, authority and accountability in accordance with the Company Law. The Companies

Act, 2013 has for the first time recognized the concept of **Key Managerial Personnel**. As per section 2(51) “key managerial personnel”, in relation to a company, means –

(i) the Chief Executive Officer or the managing director or the manager;

(ii) **the company secretary;**

(iii) the whole-time director;

(iv) the Chief Financial Officer; and

(v) such other officer as may be prescribed.

Disadvantages of Incorporation

There are, however, certain disadvantages and inconveniences in Incorporation. Some of these disadvantages are:

1. *Formalities and expenses:* Incorporation of a company is coupled with complex, cumbersome and detailed legal formalities and procedures, involving considerable amount of time and money. Such elaborate procedures have been laid down to deter persons who are not serious about doing business, as a company enjoys various facilities from the community. Even after the company is incorporated, its affairs and working must be conducted strictly in accordance with legal provisions. Thus various returns and documents are required to be filed with the Registrar of Companies, some periodically and some on the happening of an event. Certain books and registers are compulsorily required to be maintained by a company. Approval and sanction of the Company Law Board/National Company Law Tribunal / National Company Law Appellate Tribunal , the Government, the Court, the Registrar of Companies or other appropriate authority, as the case may be, is necessarily required to be obtained for certain corporate activities. Certain corporate activities such as corporate meetings, accounts, audit, borrowings, lending, investment, issue of capital, dividends etc. are necessarily required to be conducted and carried out strictly in accordance with the provisions of the Act and within the prescribed time. Any breach of the legal provisions is followed by severe penal consequences. Other forms of business organisations are comparatively free from these legal complexities and procedural formalities.
2. *Corporate disclosures:* Notwithstanding the elaborate legal framework designed to ensure maximum disclosure of corporate information, the members of a company are having comparatively restricted accessibility to its internal management and day-to-day administration of corporate working.
3. *Separation of control from ownership:* Members of a company are not having as effective and intimate control over its working as one can have in other forms of business organisation, say, a partnership firm. This is particularly so in big companies in which the number of members is too large to exercise any effective control over its day-to-day affairs. No member of a company can act in his individual capacity for and on behalf of the company. The members of a company are neither the owners nor the agents of the company. Thus, the position of ownership of members is more passive in nature. The members may not have an active and complete control over the company’s working as the partners may have over the firm’s affairs.
4. *Greater social responsibility:* Having regard to the enormous powers wielded by the companies and the impact they have on the society, the companies are called upon to show greater social responsibility in their working and, for that purpose, are subject to greater control and regulation than that by which other forms of business organisation are governed and regulated.
5. *Greater tax burden in certain cases:* In certain circumstances, the tax burden on a company is more than that on other forms of business organisation. A company is liable to tax without any minimum taxable limit as is prescribed in the cases of registered partnership firms and others. Also it has to pay income-tax on

the whole of its income at a flat rate whereas others are taxed on graduated scale or slab system. These tax implications may have crucial bearing on a decision regarding the selection of any form of business organisation and the time when the existing form of business organisation should be changed to a new one. Thus, tax implications may direct the adoption of the partnership form of business organisation as expedient at the initial stage to be converted into a company later on, when the tax implications may be more favourable because of the size of the organisation and its scale of operations.

6. *Detailed winding-up procedure:* The Act provides elaborate and detailed procedure for winding-up of companies which is more expensive and time consuming than that which is applicable to other forms of business organisation.

There are, however, some exceptions to the principles of Corporate Personality and the Limited Liability of members. These are discussed below:

Lifting or Piercing the Corporate Veil

Law has clothed a corporation with a distinct personality, yet in reality it is an association of persons who are in fact, in a way, the beneficial owners of the property of the body corporate. A company, being an artificial person, cannot act on its own, it can act only through natural persons.

Indeed, the theory of corporate entity is still the basic principle on which the whole law of corporations is based. But as the separate personality of the company is a statutory privilege, it must be used for legitimate business purposes only. Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will breakthrough the corporate shell and apply the principle of what is known as "lifting of or piercing through the corporate veil". The Court will look behind the corporate entity and take action as though no entity separate from the members existed and make the members or the controlling persons liable for debts and obligations of the company.

The corporate veil is lifted when in defence proceedings, such as for the evasion of tax, an entity relies on its corporate personality as a shield to cover its wrong doings. [*BSN (UK) Ltd.* v. *Janardan Mohandas Rajan Pillai* [1996] 86 Comp. Cas. 371 (Bom).]

In the following cases the Courts have lifted the corporate veil:

1. Where the corporate veil has been used for commission of fraud or improper conduct, Courts have lifted the veil and looked at the realities of the situation. In *Gilford Motor Co.* v. *Horne,* (1933) 1 Ch. 935, a former employee of a company made a covenant not to solicit its customers. He formed a company which undertook solicitation. The company was restrained by the Court.

2. Where the corporation is really an agency or trust for some one else and the corporate facade is used to cover up that agency or trust. In re *R.G. Films Ltd.,* (1953) 1 All E.R. 615, an American company produced a film in India technically in the name of a British Company, 90% of whose capital was held by the President of the American Company which financed the production of the film. Board of Trade refused to register the film as a British film on the ground that English company acted merely as the nominee of the American corporation.

3. Where the doctrine conflicts with public policy, Courts have lifted the corporate veil for protecting the public policy. In *Connors Bros.* v. *Connors* (1940) 4 All E.R. 179, the principle was applied against the managing director who made use of his position contrary to public policy. In this case, the House of Lords determined the character of the company as "enemy" company, since the persons who were *de facto* in control of its affairs, were residents of Germany, which was at war with England at that time. The alien company was not allowed to proceed with the action, as that would have meant giving money to the enemy, which was considered as monstrous and against "public policy".

4. For determining the true character or status of the company. In *Daimler Co. Ltd.* v. *Continental Tyre and Rubber Co.,* (1916) 2 A.C. 307, the Court looked behind the facade of the company and its place of registration in order to determine the true character of the company, i.e., whether it was an "enemy" company.
5. Where the veil has been used for evasion of taxes and duties, the Court upheld the piercing of the veil to look at the real transaction. (*Commissioner of Income Tax* v. *Meenakshi Mills Ltd.,* A.I.R. (1967) S.C. 819).
6. Where it was found that the sole purpose for which the company was formed was to evade taxes the Court will ignore the concept of separate entity, and make the individuals liable to pay the taxes which they would have paid but for the formation of the company. In the case of *Sir Dinshaw Manakjee Petit, AIR 1927 Bombay 371,* the assessee was a wealthy man enjoying large dividend and interest income. He formed four private companies and agreed with each to hold a block of investment as an agent for it. Income received was credited in the accounts of the company but the company handed back the amount to him as a pretended loan. This way he divided his income in four parts in a bid to reduce his tax liability. The Court disregarded the corporate entity on the grounds that the company was formed by the assessee purely and simply as a means of avoiding tax and the company was nothing more than the assessee himself.
7. Where the purpose of company formation was to avoid welfare legislation. Where it was found that the sole purpose for the formation of the new company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction (*The Workmen Employed in Associated Rubber Industries Limited, Bhavnagar* v. *The Associated Rubber Industries Ltd., Bhavnagar and another,* A.I.R. 1986 SC 1).

KINDS OF COMPANIES

The Companies Act, 2013 provides for a variety of companies of which can be promoted and registered under the Act. These companies may be:

(i) limited by shares;

(ii) limited by guarantee; or

(iii) unlimited companies.

Companies may also be classified as:

(a) Private Companies;

(b) Public Companies;

(c) One Person Company

(d) Company with charitable objects, etc. under Section 8 of the Companies Act, 2013;

(e) Small Company

(f) Government companies;

(g) Foreign companies;

(h) Holding companies; and

(i) Subsidiary companies.

(j) Producer Companies.

A brief discussion of each type of company follows hereunder.

A Company Limited by Shares

A company limited by shares may be defined as a "registered company" whether public or private company having the liability of its members limited by its memorandum to the amount, if any, unpaid on the shares respectively held by them. In other words, a member of a company limited by shares is required to pay only the nominal amount of shares held by him and nothing more. If the shares are fully paid-up he has nothing more to pay.

A Company Limited by Guarantee

A company limited by guarantee is a registered company having the liability of its members limited by its memorandum to such an amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up.

A special feature of this type of company is that the liability of members to pay their guarantee amount arises only when the company goes into liquidation and not when it is a going concern.

Clubs, trade associations and societies for promoting different objects are at times incorporated as companies limited by Guarantee to take the advantages of incorporation without running the risk of heavy liabilities.

An Unlimited Company

An unlimited company is a company not having any limit on the liability of its members. Thus, the maximum liability of the members of such a company, in the event of its being wound up, might stretch up to the full extent of their properties to meet the obligations of the company by contributing to its assets. However, the members of an unlimited company are not liable directly to the creditors of the company, as in the case of partners of a firm. The liability of the members is only towards the company and in the event of its being wound up only the liquidator can ask the members to contribute to the assets of the company which will be used in discharging the debts of the company.

A company registered as an unlimited company may subsequently convert itself as a limited company, subject to the condition that any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the unlimited company before such conversion are not affected by such changed registration.

Private Company [Section 2(68)]

By virtue of Section 2(68) of Companies Act, 2013 "private company" means a company having a minimum paid up share capital of one lakh rupees or such higher paid-up share capital as may be prescribed, and which by its articles, –

(i) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:

Provided further that –

(A) persons who are in the employment of the company; and

(B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and

(iii) prohibits any invitation to the public to subscribe for any securities of the company;

Maximum number of members that a private company can have is 200.

There should be at least two persons to form a private company. A private company can therefore be registered with a minimum of 2 members and cannot have more than 200 members (excluding employee and ex-employee members). It cannot invite the public to subscribe for its shares or debentures nor can its shares be freely transferred.

The words "Private Limited" must be added at the end of its name by a private limited company.

Public Company [Section 2(71)]

"Public company" means a company which –

(a) is not a private company;

(b) has a minimum paid-up share capital of five lakh rupees or such higher paid-up capital, as may be prescribed:

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles;

It is clarified the status of a private company which is a subsidiary of a public company by providing specifically in the proviso that such company shall be deemed to be public company irrespective of its status as private company in its articles.

Distinction between a Public and a Private Company

1. *Minimum number:* The minimum number of persons required to form a public company is 7. It is 2 in case of a private company.
2. *Maximum number:* There is no restriction on maximum number of members in a public company, whereas the maximum number cannot exceed 200 in a private company.
3. *Number of directors:* A public company must have at least 3 directors, whereas a private company must have at least 2 directors.
5. *Restriction on invitation to subscribe for shares:* A public company invites the general public to subscribe for the shares in, or the debentures of the company. A private company by its Articles prohibits any such invitation to the public.
6. *Transferability of shares:* In a public company, the shares are freely transferable. In a private company the right to transfer shares is restricted by the Articles.
7. *Special privileges:* A private company enjoys some special privileges. A public company enjoys no such privileges.

One Person Company (OPC)

With the implementation of the Companies Act, 2013, a single person could constitute a Company, under the One Person Company (OPC) concept. The introduction of OPC in the legal system is a move that would encourage corporatisation of micro businesses and entrepreneurship.

As per section 2(62) of the Companies Act, 2013, "One Person Company" means a company which has only one person as a member.

The memorandum of One Person Company is required to indicate the name of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.

Other conditions for One Person Company are as under:

(1) Only a natural person who is an Indian citizen and resident in India –

(a) shall be eligible to incorporate a One Person Company;

(b) shall be a nominee for the sole member of a One Person Company.

It may be noted that "resident in India" means a person who has stayed in India for a period of not less than one hundred and eighty two days during the immediately preceding one calendar year.

(2) No person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company.

(3) No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest.

(4) Such Company cannot be incorporated or converted into a company under section 8 of Companies Act, 2013(section 8 deals with Formation of company with charitable objects, etc.)

(5) Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of any body corporates.

(6) No such company can convert voluntarily into any kind of company unless two years have expired from the date of incorporation of One Person Company, except threshold limit (paid up share capital) is increased beyond fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees.

Company with charitable objects

Section 8 of the Companies Act, 2013 provides that where it is proved to the satisfaction of the Central Government that a person or an association of persons proposed to be registered as a limited company –

(*a*) has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;

(*b*) intends to apply its profits, if any, or other income in promoting its objects; and

(*c*) intends to prohibit the payment of any dividend to its members,

The Central Government may, by licence issued in such prescribed manner and on such conditions as it deems fit, allow that person or association of persons to be registered as a limited company without the addition to its name of the word "Limited", or as the case may be, the words "Private Limited", and thereupon the Registrar shall, on application, in the prescribed form, register such person or association of persons as a company under this section.

(*2*) The company registered under section 8 shall enjoy all the privileges and be subject to all the obligations of limited companies.

(*3*) A firm may be a member of the company registered under this section.

(*4*) A company registered under section 8 shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.

(*5*) A company registered under section 8 may convert itself into company of any other kind only after complying with such prescribed conditions.

(*6*) The Central Government may, by order, revoke the licence granted to a company registered under this section if the company contravenes any of the requirements or any of the conditions subject to which a licence is issued or the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest, and without prejudice to any other action against the company under this Act, direct the company to convert its status and change its name to add the word “Limited” or the words “Private Limited”, as the case may be, to its name and thereupon the Registrar shall register the company accordingly.

(*7*) Where a licence is revoked , the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act or amalgamated with another company registered under this section.

Small Company

Small company is a new form of private company under the Companies Act, 2013. A classification of a private company into a small company is based on its size i.e. paid up capital and turnover. In other words, such companies are small sized private companies.

As per section 2(*85*) ‘‘small company’’ means a company, other than a public company, –

(i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; or

(ii) turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees:

Provided that nothing in this defintion shall apply to –

(A) a holding company or a subsidiary company;

(B) a company registered under section 8; or

(*C*) a company or body corporate governed by any special Act;

Government Companies

Section 2(45) of the Companies Act, 2013 defines “Government Company” as any company in which not less than fifty one per cent. of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

Where the Central Government is a member of a Government company, the Central Government shall cause an annual report on the working and affairs of that company to be prepared within three months of its annual general meeting, and laid before both Houses of Parliament together with a copy of the audit report and comments upon or supplement to the audit report, made by the Comptroller and Auditor-General of India.

Where in addition to the Central Government, any State Government is also a member of a Government company, that State Government shall cause a copy of the annual report prepared within three months of its annual general meeting and laid before the House or both Houses of the State Legislature together with a copy of the audit report and the comments upon or supplement to the audit report, made by the Comptroller and Auditor-General of India.

Where the Central Government is not a member of a Government company, every State Government which is a member of that company, or where only one State Government is a member of the company, that State Government shall cause an annual report on the working and affairs of the company to be prepared and as soon as may be after such preparation, laid before the House or both Houses of the State Legislature together with a copy of the audit report and comments upon or supplement to the audit report made by the Comptroller and Auditor-General of India.

Foreign Companies

As per section 2(42) of the Companies Act, 2013 “foreign company” means any company or body corporate incorporated outside India which –

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) conducts any business activity in India in any other manner.

Where not less than fifty per cent. of the paid-up share capital, whether equity or preference or partly equity and partly preference, of a foreign company is held by one or more citizens of India or by one or more companies or bodies corporate incorporated in India, or by one or more citizens of India and one or more companies or bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with the provisions of Chapter XXIII deals with companies incorporated outside India contains Sections 379 to 395 and such other prescribed provisions of the Companies Act, 2013 as may be with regard to the business carried on by it in India as if it were a company incorporated in India.

Holding company

As per Section 2(46) of the Companies Act, 2013, holding company, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

Subsidiary company

Section 2(87) of the Companies Act, 2013 provides that subsidiary company or subsidiary, in relation to any other company (that is to say the holding company), means a company in which the holding company—

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

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

Provided that such class or classes of holding companies, shall not have layers of subsidiaries beyond the prescribed limit. (Proviso to be notified)

For the above purpose, –

(a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(b) the composition of a company’s Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

(c) the expression “company” includes any body corporate;

It may be noted that according to section 2 (27) of the Companies Act, 2013 , control shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

Producer Company

Section 465(1) of the Companies Act, 2013 provides that the Companies Act, 1956 and the Registration of Companies (Sikkim) Act, 1961 (hereafter in this section referred to as the repealed enactments) shall stand repealed.

However, proviso to section 465(1) provides that the provisions of Part IX A of the Companies Act, 1956 shall be applicable mutatis mutandis to a Producer Company in a manner as if the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies.

In view of the above provision, Producer Companies are still governed by the Companies Act, 1956. Companies (Amendment) Act, 2002 had added a new Part IXA to the main Companies Act, 1956 consisting of 46 new Sections from 581A to 581ZT relating to Producer Companies.

According to the provisions as prescribed under Section 581A(l) of the Companies Act, 1956, a producer company is a body corporate having objects or activities specified in Section 581B and which is registered as such under the provisions of the Act. The membership of producer companies is open to such people who themselves are the primary producers, which is an activity by which some agricultural produce is produced by such primary producers.

PROMOTION AND INCORPORATION OF A COMPANY

Any seven or more persons can form a public company and any two or more persons can form a private company and one person can form One Person Company. However, the company should be formed for a lawful purpose i.e. it should not be in contravention of the general law of the country. Every company public or private has to be registered with the Registrar of Companies (ROC). The ROC is the authority which besides registration of companies, receives documents and forms from companies and registers them, maintains records of the companies and makes this record available for public inspection as well as ensures that companies by and large comply with the provisions of Companies Act, 2013 .

The whole process of the company formation may be divided into three distinct stages, namely:

(i) Promotion;

(ii) Incorporation by Registration; and

(iii) Commencement of Business.

Promotion

"Promotion" is the process of conceiving an idea and developing it into a concrete proposition or project to be accomplished by the incorporation and floatation of a company. The person who takes the necessary steps to accomplish these objectives is known as promoter.

Promoters

Section 2 (69) of the Companies Act, 2013 defines the term 'promoter' as under:-

"Promoter" means a person –

(a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or

(b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or

(c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

Provided that sub-clause (c) shall not apply to a person who is acting merely in a professional capacity.

By virtue of above definition, persons in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act are also treated as promoters. However, if a person is merely acting in a professional capacity i.e. giving only professional advice to the Board of directors, he shall not be treated as a promoter.

Is a director/officer/employee of the issuer a promoter?

A director/officer/employee who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise is considered as a promoter. As per section 2 (27), control" shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

However, a director or officer or employee of the issuer or a person, if acting as such merely in his professional capacity, shall not be deemed as a promoter.

PROMOTERS' CONTRACT — RATIFICATION THEREOF

As regards ratification of promoters' contracts, the view taken in *Kelner* v. *Baxter LR* (1886) 2 CP 174 was that the company could not ratify contract made by a promoter before its incorporation. Specific performance of a contract may be enforced against a company in respect of contracts entered into by promoters on behalf of the company, if such a contract is warranted by the terms of incorporation and the company has accepted the contract and communicated the acceptance to the other party. (Section 15 of the Specific Relief Act, 1963). Section 19 of the same Act provides that the other party can also enforce the contract if the company has adopted it after incorporation and the contract is within the terms of incorporation.

As long as the company does not ratify, as required by the Specific Relief Act, 1963 the position remains the same as under the common law.

Legal Position of a Promoter

While the accurate description of a promoter may be difficult, his legal position is quite clear. A promoter is neither an agent of, nor a trustee for, the company because it is not in existence. But he occupies a fiduciary position in relation to the company and therefore requires to make full disclosure of the relevant facts, including any profit made by him.

The corollary which the law deduces from this rule of fiduciary relationship is that a promoter may not make, either directly or indirectly, any profit at the expense of the company, he promotes, without the knowledge and consent of the company, and that, if he does make a secret profit in disregard of this rule, the company can compel him to account for it, and surrender the secret profit. When the promoter defrauds the company, he becomes liable for damages and on his death his estate remains liable if it has benefitted from the deceit or breach of trust, but not otherwise.

INCORPORATION OF COMPANIES - PROCEDURAL ASPECTS

(a) Application for Availability of Name of company

A company being a legal entity must have a name of its own to establish its separate identity. The name of the company is a symbol of its independent corporate existence. The first clause in the memorandum of association of the company states the name by which a company is to be known. The company may adopt any suitable name provided it is not undesirable.

According to section 4(*2*) of the Companies Act, 2013, the name stated in the memorandum shall not –

(a) be identical with or resemble too nearly to the name of an existing company registered under this Act or any previous company law; or

(b) be such that its use by the company –

   (i) will constitute an offence under any law for the time being in force; or

   (ii) is undesirable in the opinion of the Central Government.

Section 4(*3*) of the Companies Act, 2013 provides that without prejudice to the provisions of section 4(*2*), a company shall not be registered with a name which contains—

(*a*) any word or expression which is likely to give the impression that the company is in any way connected with, or having the patronage of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force; or

(*b*) such word or expression, as may be prescribed, unless the previous approval of the Central Government has been obtained for the use of any such word or expression.

As per section 4(*4*) a person may make an application, in such form and manner and accompanied by such fee, as may be prescribed, to the Registrar for the reservation of a name set out in the application as—

(a) the name of the proposed company; or

(b) the name to which the company proposes to change its name.

Section 4(*5*)(i) lays down that upon receipt of an application under sub-section (*4*), the Registrar may, on the basis of information and documents furnished along with the application, reserve the name for a period of 60 days from the date of the application.

As stated above, section 4(2) provides that the name stated in the memorandum shall not be such that its use by the company, in the opinion of the Central Government, is undesirable. A name which is identical to or too nearly resembles, the name by which a company in existence has been previously registered, will be deemed to be undesirable

The object is to prevent the use of a name likely to mislead the public. For example, a company is not allowed to use a name which is prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950, or suggestive of any connection with Government or of State patronage where there is none

As per Rule 9 of Companies (incorporation) Rules 2014, an application for the reservation of a name shall be made in Form No. INC.1 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014.

(b) Preparation of Memorandum and Articles of Association

The Memorandum of Association

The Memorandum of Association is a document which sets out the constitution of a company and is therefore the foundation on which the structure of the company is built. It defines the scope of the company's activities and its relations with the outside world.

The first step in the formation of a company is to prepare a document called the memorandum of association. In fact memorandum is one of the most essential pre-requisites for incorporating any form of company under the Act. This is evidenced in Section 3 of the Act, which provides the mode of incorporation of a company and states that a company may be formed for any lawful purpose by seven or more persons, where the company to be formed is a public company; two or more persons, where the company to be formed is a private company; or one person, where the company to be formed is a One Person Company by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of its registration.

To subscribe means to append one's signature or mark a document as an approval or attestation of its contents.

According to Section 2(56) of the Companies Act, 2013 "memorandum" means the memorandum of association of a company as originally framed and altered from time to time in pursuance of any previous company law or this Act.

Section 4 of the Companies Act, 2013 specifies in clear terms the contents of this important document which is the charter of the company. The memorandum of association of a company contains the objects to pursue which the company is formed It not only shows the objects of formation but also determines the scope of its operations beyond which its actions cannot go. "THE MEMORANDUM OF ASSOCIATION", observed Palmer, "is a document of great importance in relation to the proposed company".

Memorandum of Association is the charter of a company. It is a document, which amongst other things, defines the area within which the company can operate.

Section 4(1) states that the memorandum of a company shall state –

(a) the name of the company with the last word "Limited" in the case of a public limited company, or the last words "Private Limited" in the case of a private limited company

(b) the State in which the registered office of the company is to be situated;

(c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof;

(d) the liability of members of the company, whether limited or unlimited, and also state,— (i) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and (ii) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute – (A) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and (B) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;

(e) in the case of a company having a share capital, – (i) the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share; and (ii) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name;

(f) in the case of One Person Company, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

Article of Association

According to Section 2(5) of the Companies Act, 2013, 'articles' means the articles of association of a company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act. It also includes the regulations contained in Table A in Schedule I of the Act, in so far as they apply to the company.

In terms of section 5(1) of the Companies Act, 2013, the articles of a company shall contain the regulations for management of the company. The articles of association of a company are its bye-laws or rules and regulations that govern the management of its internal affairs and the conduct of its business. The articles play a very important role in the affairs of a company. It deals with the rights of the members of the company inter se. They are subordinate to and are controlled by the memorandum of association. The general functions of the articles have been aptly summed up by Lord Cairns, L.C. in *Ashbury Railway Carriage and Iron Co. Ltd.* v. *Riche,* (1875) L.R. 7 H.L. 653 as follows:

“The articles play a part that is subsidiary to the memorandum of association. They accept the memorandum of association as the charter of incorporation of the company, and so accepting it, the articles proceed to define the duties, rights and powers of the governing body as between themselves and the company at large, and the mode and form in which business of the company is to be carried on, and the mode and form in which changes in the internal regulations of the company may from time to time be made... The memorandum, is as it were... the area beyond which the action of the company cannot go; inside that area shareholders may make such regulations for the governance of the company as they think fit”.

Thus, the memorandum lays down the scope and powers of the company, and the articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members. But they must keep within the limits marked out by the memorandum and the Companies Act.

The articles must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to the memorandum and duly witnessed and filed along with the memorandum. The articles must not contain anything illegal or *ultra vires* the memorandum, nor should it be contrary to the provisions of the Companies Act, 2013.

CONTENTS OF ARTICLES

The articles set out the rules and regulations framed by the company for its own working. The articles should contain generally the following matters:

1. Exclusion wholly or in part of Table F.
2. Adoption of preliminary contracts.
3. Number and value of shares.
4. Issue of preference shares.
5. Allotment of shares.
6. Calls on shares.
7. Lien on shares.
8. Transfer and transmission of shares.
9. Nomination.
10. Forfeiture of shares.
11. Alteration of capital.
12. Buy back.
13. Share certificates.
14. Dematerialisation.
15. Conversion of shares into stock.

16. Voting rights and proxies.
17. Meetings and rules regarding committees.
18. Directors, their appointment and delegations of powers.
19. Nominee directors.
20. Issue of Debentures and stocks.
21. Audit committee.
22. Managing director, Whole-time director, Manager, Secretary.
23. Additional directors.
24. Seal.
25. Remuneration of directors.
26. General meetings.
27. Directors meetings.
28. Borrowing powers.
29. Dividends and reserves.
30. Accounts and audit.
31. Winding up.
32. Indemnity.
33. Capitalisation of reserves.

Utmost caution must be exercised in the preparation of the articles of association of a company. At the same time, certain provisions of the Act are applicable to the company "notwithstanding anything to the contrary in the articles". Therefore, the articles must contain provisions in respect of all matters which are required to be contained therein so as not to hamper the working of the company later.

Section 5(1) of the Companies Act, 2013 states that the articles of a company shall contain the regulations for management of the company.

FILING OF DOCUMENTS WITH REGISTRAR OF COMPANIES

Section 7(1) of the Companies Act, 2013 states that there shall be filed with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated, the following documents and information for registration, namely: –

(a) Application for Incorporation of Companies

Rule 12 of Companies (Incorporation) Rules 2014 states that an application for incorporation shall be filed with ROC in form INC-2 (in case of one person company or INC-7 in case of other companies.

(b) Memorandum and Articles of Association of the company duly signed

Section 7(1)(a) the filing of the memorandum and articles of the company duly signed by all the subscribers to the memorandum in such manner as may be prescribed;

Rule 13 of Companies (Incorporation) Rules 2014 states that –

The Memorandum and Articles of Association of the company shall be signed in the following manner, namely:-

(1) The memorandum and articles of association of the company shall be signed by each subscriber to the memorandum, who shall add his name, address, description and occupation, if any, in the presence of at least one witness who shall attest the signature and shall likewise sign and add his name, address, description and occupation, if any and the witness shall state that "I witness to subscriber/subscriber(s), who has/have subscribed and signed in my presence (date and place to be given); further I have verified his or their Identity Details (ID) for their identification and satisfied myself of his/her/their identification particulars as filled in"

(2) Where a subscriber to the memorandum is illiterate, he shall affix his thumb impression or mark which shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and authenticate it by his own signature and he shall also write against the name of the subscriber, the number of shares taken by him.

(3) Such person shall also read and explain the contents of the memorandum and articles of association to the subscriber and make an endorsement to that effect on the memorandum and articles of association.

(4) Where the subscriber to the memorandum is a body corporate, the memorandum and articles of association shall be signed by director, officer or employee of the body corporate duly authorized in this behalf by a resolution of the board of directors of the body corporate and where the subscriber is a Limited Liability Partnership, it shall be signed by a partner of the Limited Liability Partnership, duly authorized by a resolution approved by all the partners of the Limited Liability Partnership:

Provided that in either case, the person so authorized shall not, at the same time, be a subscriber to the memorandum and articles of Association.

(5) Where subscriber to the memorandum is a foreign national residing outside India-

(a) in a country in any part of the Commonwealth, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized by a Notary (Public) in that part of the Commonwealth.

(b) in a country which is a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized before the Notary (Public) of the country of his origin and be duly apostillised in accordance with the said Hague Convention.

(c) in a country outside the Commonwealth and which is not a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and articles of association and proof of identity, shall be notarized before the Notary (Public) of such country and the certificate of the Notary (Public) shall be authenticated by a Diplomatic or Consular Officer empowered in this behalf under section 3 of the Diplomatic and Consular Officers (Oaths and Fees) Act, 1948 (40 of 1948) or, where there is no such officer by any of the officials mentioned in section 6 of the Commissioners of Oaths Act, 1889 (52 and 53 Vic.C.10), or in any Act amending the same;

(d) visited in India and intended to incorporate a company, in such case the incorporation shall be allowed if, he/she is having a valid Business Visa.

Explanation.- For the purposes of this clause, it is hereby clarified that, in case of Person is of Indian Origin or Overseas Citizen of India, requirement of business Visa shall not be applicable.

(c) Declaration from the professional

Section 7(1)((b) of the Companies Act, 2013 requires filing of a declaration in the prescribed form by an advocate, a chartered accountant, cost accountant or company secretary in practice, who is engaged in the formation of the company, and by a person named in the articles as a director, manager or secretary of the company, that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with;

Rule 14 of The Companies (Incorporation) Rules 2014 states that for the purposes of clause (b) of sub-section (1) of section 7, the declaration by an advocate, a Chartered Accountant, Cost accountant or Company Secretary in practice shall be in Form No. INC.8.

Explanation (i) "chartered accountant" means a chartered accountant as defined in clause (b) of sub section 1 of section 2 of the Chartered Accountants Act, 1949 (ii) "Cost Accountant" means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 and (iii) "company secretary" means a "company secretary" or "secretary" means as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980.

(d) Affidavit from the subscribers to the Memorandum

Section 7(1)(c) of the Companies Act, 2013 requires the filing of an affidavit from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles that he is not convicted of any offence in connection with the promotion, formation or management of any company, or that he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the preceding five years and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief;

Rule 15 of The Companies (Incorporation) Rules 2014 states that

For the purposes of clause (c) of sub-section (1) of section 7, the affidavit shall be submitted by each of the subscribers to the memorandum and each of the first directors named in the articles in Form No.INC.9

(e) Furnishing verification of Registered Office

Under Section 12 of the Companies Act, 2013, a company shall, on and from the 15th day of its incorporation and at all times thereafter, have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it. The company can furnish to the registrar verification of registered office with in 30 days of incorporation in the manner prescribed. As per rule 25(1) of Companies (Incorporation) Rules 2014, the verification of registered office shall be filed in Form no INC 22.

Where the location of the registered office is finalised prior to Incorporation of a company by the promoters, the promoters can also file along with the Memorandum and Articles, the verification of its registered office in Form no INC 22.

(f) Particulars of subscribers

Section 7(1)(e) of the Companies Act, 2013 requires the filing of the particulars of name, including surname or family name, residential address, nationality and such other particulars of every subscriber to the memorandum along with proof of identity, as may be prescribed, and in the case of a subscriber being a body corporate, such particulars as may be prescribed;

Rule 16 of Companies (Incorporation) Rules states that –

Particulars of every subscriber to be filed with the Registrar at the time of incorporation.

(1) The following particulars of every subscriber to the memorandum shall be filed with the Registrar –

  (a) Name (including surname or family name) and recent Photograph affixed and scan with MOA and AOA:

  (b) Father's/Mother's/ name:

  (c) Nationality:

(d) Date of Birth:

(e) Place of Birth (District and State):

(f) Educational qualification:

(g) Occupation:

(h) Income-tax permanent account number: (i) Permanent residential address and also Present address (Time since residing at present address and address of previous residence address (es) if stay of present address is less than one year) similarly the office/business addresses :

(j) Email id .... of Subscriber;

(k) Phone No. .... of Subscriber;

(l) Fax no. .... of Subscriber (optional)

Explanation. – information related to (i) to (l) shall be of the individual subscriber and not of the professional engaged in the incorporation of the company;

(m) Proof of Identity:

For Indian Nationals:

– PAN Card (mandatory) and any one of the following

– Voter's identity card

– Passport copy

– Driving License copy

– Unique Identification Number (UIN)

For Foreign nationals and Non Resident Indians

– Passport

It was clarified by MCA vide Circular No. 16/2014 that, a declaration from foreign national in the prescribed format shall be furnished as an attachment of INC 7 (Application for Incorporation), in case if he does not have a PAN.

(n) Residential proof such as Bank Statement, Electricity Bill, Telephone / Mobile Bill:

Provided that Bank statement Electricity bill, Telephone or Mobile bill shall not be more than two months old;

(o) Proof of nationality in case the subscriber is a foreign national.

(p) If the subscriber is already a director or promoter of a company(s), the particulars relating to-

(i) Name of the company;

(ii) Corporate Identity Number;

(iii) Whether interested as a director or promoter;

(q) the specimen signature and latest photograph duly verified by the banker or notary shall be in the prescribed Form No.INC.10.

(2) Where the subscriber to the memorandum is a body corporate, then the following particulars shall be filed with the Registrar –

(a) Corporate Identity Number of the Company or Registration number of the body corporate, if any

(b) GLN, if any;

(c) the name of the body corporate

(d) the registered office address or principal place of business;

(e) E-mail Id;

(f) if the body corporate is a company, certified true copy of the board resolution specifying inter alia the authorization to subscribe to the memorandum of association of the proposed company and to make investment in the proposed company, the number of shares proposed to be subscribed by the body corporate, and the name, address and designation of the person authorized to subscribe to the Memorandum;

(g) if the body corporate is a limited liability partnership or partnership firm, certified true copy of the resolution agreed to by all the partners specifying inter alia the authorization to subscribe to the memorandum of association of the proposed company and to make investment in the proposed company, the number of shares proposed to be subscribed in the body corporate, and the name of the partner authorized to subscribe to the Memorandum;

(h) the particulars as specified above for subscribers in terms of clause (e) of sub- section (1) of section 7 for the person subscribing for body corporate;

  (i) in case of foreign bodies corporate, the details relating to-

  (ii) the copy of certificate of incorporation of the foreign body corporate; and

  (iii) the registered office address.

(g) Particulars of first directors along with their consent to act as directors

Section 7(1)(f) of the Companies Act, 2013 requires filing of the particulars of the persons mentioned in the articles as the first directors of the company, their names, including surnames or family names, the Director Identification Number, residential address, nationality and such other particulars including proof of identity as may be prescribed.

Section 7(1)(g) of the Companies Act, 2013 states that the particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed.

Rule 17 of Companies (Incorporation) Rules 2014 states that –

The particulars of each person mentioned in the articles as first director of the company and his interest in other firms or bodies corporate along with his consent to act as director of the company shall be filed in Form No.DIR.12 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014.

As per section 152 (*3*), no person shall be appointed as a director of a company unless he has been allotted the Director Identification Number under section 154. Section 152(*4*) provides that every person proposed to be appointed as a director by the company in general meeting or otherwise, shall furnish his Director Identification Number. By virtue of section 153, every individual intending to be appointed as director of a company shall make an application for allotment of Director Identification Number in Form no Dir 3. Any individual who intends to be a director of a company will have to mandatorily apply for DIN first. DIN has to be obtained by the directors of the company before commencing the procedure for incorporation of a company.

(h) Power of Attorney

With a view to fulfilling the various formalities that are required for incorporation of a company, the promoters may appoint an attorney empowering him to carry out the instructions/requirements stipulated by the Registrar. This requires execution of a Power of Attorney on a non-judicial stamp paper of a value prescribed in the respective State Stamp Laws.

Issue of Certificate of Incorporation by Registrar

Section 7(2) of the Companies Act, 2013 states that the Registrar on the basis of documents and information filed under sub-section (1) of section 7, shall register all the documents and information referred to in that sub-section in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

From the date of incorporation mentioned in the certificate of incorporation, such subscribers to the memorandum and all other persons, as may, from time to time, become members of the company, shall be a body corporate by the name contained in the memorandum, capable of exercising all the functions of an incorporated company under this Act and having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name (Section 9). The subscribers would become the members of the company.

Conclusive Evidence

A Certificate of Incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requirements of the Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorised to be registered and duly registered under the Act. The Certificate of Incorporation is conclusive evidence that everything is in order as regards registration and that the company has come into existence from the earliest moment of the day of incorporation stated therein with rights and liabilities of a natural person, competent to enter into contracts [*Jubilee Cotton Mills Ltd.* v. *Lewis,* (1924) (A.C. 958)]. The validity of the registration cannot be questioned after the issue of the certificate.

In *Moosa* v. *Ebrahim ILR* (1913) 40 Cal. 1 (P.C.) the Memorandum of Association of a company was signed by two adults and by a guardian of the other 5 subscribers, who were minors. The Registrar, however, registered the company and issued under his hand a Certificate of Incorporation. It was contended that this Certificate of Incorporation should be declared void. Lord Macnaughten said: "Their Lordships will assume that the conditions of registration prescribed by the Indian Companies Act were not duly complied with; that there were no seven subscribers to the Memorandum and that the Registrar ought not to have granted the certificate. But the certificate is conclusive for all purpose. Thus, the certificate prevents anyone from alleging that the company does not exist".

It is for the purpose of incorporation only that the certificate was made conclusive by the legislature and the certificate cannot legalise the illegal object contained in the Memorandum. Where the object of a company is unlawful, it has been held that the certificate of registration is not conclusive for this purpose, [*Performing Right Society Ltd.* v. *London Theatre of Varieties* (1992) 2 KB 433].

Allotment of Corporate identity number

Section 7(3) of the Companies Act, 2013 states that on and from the date mentioned in the certificate of incorporation issued under sub-section (2), the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate.

Commencement of Business

In terms of section 11(1) of the Companies Act, 2013 every company having a share capital shall not commence any business or exercise any borrowing powers unless –

(a) a declaration is filed by a director in such form (Form No. INC 21) and verified in such manner as may be prescribed, with the Registrar that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him and the paid-up share capital of the company is not less than Rs 5 lakh in case of a public company and not less than Rs. 1 lakh in case of a private company on the date of making of this declaration; and

(b) the company has filed with the Registrar a verification of its registered office as provided in sub-section (2) of section 12.

Rule 24 of Companies (Incorporation) Rules 2014 states that the declaration filed by a director shall be in Form INC 21, duly verified by Practicing Company Secretary, Chartered Accountant or Cost Accountant. In case the Company requiring registration from sectoral regulators/SEBI, the approval of such regulator shall be required.

If, therefore, a public company is wound up before it is entitled to commence business the persons who have rendered services or supplied goods or materials to the company can have no claim against it [*In Re. Electrical Manufacturing Co.* (1906) 2 Ch. 390].

Section 11 of the Companies Act further provides for penalty and fine. If any default is made in complying with the requirements of this section, the company shall be liable to a penalty which may extend to Rs. 5000 and every officer who is in default shall be punishable with fine which may extend to Rs. 1000 for every day during which the default continues. [Section 11(*2*)]

Where no declaration by a director has been filed with the Registrar under section 11(*1*)(a) within a period of one hundred and eighty days of the date of incorporation of the company and the Registrar has reasonable cause to believe that the company is not carrying on any business or operations, he may, without prejudice to the provisions of section 11(*2*), initiate action for the removal of the name of the company from the register of companies under Chapter XVIII. [Section 11(3)].

The approval of the Registrar of Companies of the declaration filed by a director and verification of registered office filed by the company entitles the company to commence business given in the objects clause of the Memorandum of Association. No business other than those given in the “objects clause” can be commenced without obtaining prior approval of the shareholders by way of special resolution.

How does a company function?

A company is an association of persons, upon which law confers a personality. It is an artificial person capable of doing many things, which a natural person can do, e.g., it can purchase and own property in its own name, it can enter into contracts, it can sue in its own name and can be sued likewise. In spite of this capacity, it has no physical personality of its own. It can think, express and take decisions only through others who are natural persons and who act in the name and upon the authority of the company. They are the agents of the company, known as its directors, who act together to take decisions for and on behalf of the company. However, to protect the interest of shareholders the Act provides that a number of important decisions of management have to be approved by the shareholders.

The decisions of a company are thus taken by its owners who are the shareholders, (only at their meetings and not acting individually) or by its agents viz. the directors, at their meetings or the meetings of their committees constituted for certain specific purposes.

A meeting may be generally defined as a gathering or assembly or coming together of two or more persons for transacting any lawful business. There must be at least two persons to constitute a meeting. In certain exceptional circumstances, even one person may constitute a meeting.

Company meetings: The meetings of shareholders, debenture holders, directors or creditors must be convened and held in accordance with the various provisions of the Companies Act.

LESSON ROUND UP

– Company is referred to an association of persons who took their meals together. A company may be an incorporated company or a "corporation" or an unincorporated company. It is called a body corporate because the persons composing it are made into one body by incorporating it according to the law, and clothing it with legal personality, and, so turn it into a corporation.

– The main characteristics of a company are as follow

- Corporate Personality
- Limited Liability
- Perpetual Succession
- Transferability of Shares
- Separate Property
- Common Seal
- Capacity to Sue and Be Sued

– Company is a distinguished form of business as compared to other forms.

– The companies are regulated under Companies Act 2013.

– The Companies Act, 2013 provides for a variety of companies of which can be promoted and registered under the Act. These companies may be:

- limited by shares;
- limited by guarantee; or
- unlimited companies.
- Companies may also be classified as:
  - (a) Private Companies;
  - (b) Public Companies;
  - (c) One Person Company
  - (d) Company with charitable objects, etc. under Section 8 of the Companies Act, 2013;
  - (e) Small Company
  - (f) Government companies;
  - (g) Foreign companies;
  - (h) Holding companies; and
  - (i) Subsidiary companies.
  - (j) Producer Companies.

GLOSSARY

Corporate Personality The distinct status of a business organization that has complied with law for its recognition as a legal entity and that has an independent legal existence from that of its officers, directors, and shareholders.

Limited Liability	Type of investment in which a partner or investor cannot lose more than the amount invested. The investor or partner is not personally responsible for the debts and obligations of the company in the event that these are not fulfilled.
Perpetual Succession	Continuation of an incorporated firm's existence, unaffected by the death of any of its owners or the transfer of its shares to a new entity.
Common Seal	A metal stamp for stamping the impression of a company's official signature on documents with the name of the company to show that they have been approved officially.
Foreign Company	Any company or body corporate incorporated outside India which -(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and (b) conducts any business activity in India in any other manner
Government Company	Any company in which not less than fifty one per cent. of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.
One Person Company	A company which has only one person as a member.

SELF-TEST QUESTIONS

1. Define the term "company". What are its characteristics?
2. "The fundamental attribute of corporate personality is that the company is a legal entity distinct forms the members". Comment.
3. Write short notes on:
   (i) Perpetual succession
   (ii) Transferability of shares
   (iii) Limited liability
   (iv) Corporate personality.
4. Discuss the principles of law laid down by the House of Lords in *Salomon* v. *Salomon and Co. Ltd.*
5. State in brief the various kinds of companies which can be registered under the Companies Act, 2013.
6. Write short notes on:
   (i) One-Person company
   (ii) Small Company
   (iii) Subsidiary companies
   (iv) Government company
   (v) Common Seal.
7. Define promoter? What is the legal position of a promoter vis-a-vis the company?
8. Enumerate the steps involved in the formation of a limited company.
9. Distinguish between a private company and a public company.
10. Distinguish between Company and Limited Liability Partnership.

Lesson 8
Elements of Company Law-II

LESSON OUTLINE

– Introduction
– Board of Directors
– Minimum/Maximum Number of Directors
– Number of directorships
– Woman Director
– Independent Directors
– Director elected by Small Shareholders
– Appointment of directors
– Duties of directors
– Power of Board
– Meetings of the Board
– Notice of Board Meetings
– Quorum for Board Meetings
– Key Managerial Personnel
– Managing Director
– Whole Time Director
– Manager
– Chief Executive Officer
– Chief Financial Officer
– Company Secretary
– Appointment of Key Managerial Personnel
– Appointment of Whole-Time Company Secretary
– Functions of Company Secretary
– Role of Secretary in a Company
– Members' Meetings
– Annual General Meeting
– Extra Ordinary General Meeting
– Notice of Meeting
– Contents of Notice
– Notice through Electronic Mode
– E-Governance
– E-Governance and MCA-21

LEARNING OBJECTIVES

Company has separate legal entity. Its perpetual succession leads it to longer life. The companies acts as artificial person and activities of the company are carried out by the persons. The persons are called as director and key managerial personnel who holds the power to act on behalf of company. The companies work according to the set pattern of process and the process is called meetings. The officers of the company are responsible for its day to day functioning. Company secretary is one of the said officers; who is responsible for the legal compliance of the company. He is the bridge between Board and shareholders.

The objective of this section is to articulate about the board processes and providing information about the officer of the company mainly the directors, key managerial personnel and the company secretary. The appointment, removal, qualification, etc., are important aspects of persons involved in operations of a company. Therefore, it is significant to throw light on these aspects in the backdrop of who are the persons and what process is used in laws for their processes.

There is a veil of corporate personality which protects the individual from any personal liability at all. That is the fundamental principle of our Company Law. ***- Lord Denning***

INTRODUCTION

A company, though a legal entity in the eyes of law, is an artificial person, existing only in contemplation of law. It has no physical existence. It has neither soul nor body of its own. As such, it cannot act in its own person. It can do so only through some human agency. The persons who are in charge of the management of the affairs of a company are termed as directors. They are collectively known as Board of Directors or the Board. The directors are the brain of a company. They occupy a pivotal position in the structure of the company.

The supreme executive authority controlling the management and affairs of a company vests in the team of directors of the company, collectively known as its Board of Directors. At the core of the corporate governance practice is the Board of Directors which oversees how the management serves and protects the long term interests of all the stakeholders of the Company. The institution of board of directors was based on the premise that a group of trustworthy and respectable people should look after the interests of the large number of shareholders who are not directly involved in the management of the company. The position of board of directors is that of trust as the board is entrusted with the responsibility to act in the best interests of the company.

Although the Board comprises individual directors, yet the actions and deeds of directors individually functioning cannot bind the company, unless a particular director has been specifically authorised by a Board resolution to discharge certain responsibilities on behalf of the company.

Section 2 (34) of the Companies Act, 2013 prescribed that “director” means a director appointed to the Board of a company. A director is a person appointed to perform the duties and functions of director of a company in accordance with the provisions of the Companies Act, 2013.

Board of Directors

A company, though a legal entity in the eyes of law, is an artificial person, existing only in contemplation of law. It has no physical existence. It has neither soul nor body of its own. As such, it cannot act in its own person. It can do so only through some human agency. The persons who are in charge of the management of the affairs of a company are termed as directors. They are collectively known as Board of Directors or the Board. The directors are the brain of a company. They occupy a pivotal position in the structure of the company. Directors take the decision regarding the management of a company collectively in their meetings known as Board Meetings or at the meetings of their committees constituted for certain specific purposes.

Section 2 (10) of the Companies Act, 2013 defined that “Board of Directors” or “Board”, in relation to a company, means the collective body of the directors of the company.

Minimum/Maximum Number of Directors

Section 149(1) of the Companies Act, 2013 requires that every company shall have a minimum number of 3 directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company. A company can appoint maximum 15 fifteen directors. A company may appoint more than fifteen directors after passing a special resolution in general meeting and approval of Central Government is not required.

Number of directorships

As per Section 165 of the Companies Act, 2013, maximum number of directorships, including any alternate directorship a person can hold is 20. It has come with a rider that number of directorships in public companies/ private companies that are either holding or subsidiary company of a public company shall be limited to 10. Further the members of a company may restrict abovementioned limit by passing a special resolution.

Residence of a director in India

Section 149 (3) of the Companies Act, 2013 has provided for residence of a director in India as a compulsory i.e. every company shall have at least one director who has stayed in India for a total period of not less than 182 days in the previous calendar year.

Woman Director

Every listed company shall appoint at least one woman director and Every other public company having paid up share capital of Rs. 100 crores or more or turnover of Rs. 300 crore or more as on the last date of latest audited financial statements, shall also appoint at least one woman director under Section 149(1) of the Companies Act, 2013.

Independent Directors

Section 2(47) of the Companies Act, 2013 prescribed that "Independent director" means an independent director referred to in sub section (5) of section 149 of the Act. In fact reference should have been made to sub section (6) of 149 as it specified the qualifications of independent director with clarity.

An independent director means a director other than a managing director or a whole-time director or a nominee director who does not have any material or pecuniary relationship with the company/ directors. Section 149(6) of the Act prescribes the criteria for independent directors which are as follows:

(a) Who in the opinion of the Board, is a person of integrity and possesses relevant industrial expertise and experience;

(b) Such individual shall not be a promoter or related to promoter of the company or its holding, subsidiary or associate company;

(c) Such individuals must not have any material or pecuniary relationship during the two immediately preceding financial years or during the current financial year with the company or its promoters/directors/holding/ subsidiary/ associate company;

(d) The relatives of such person should not have had any pecuniary relationship with the company or its subsidiaries, amounting to 2% or more of its gross turnover or total income or Rs. 50 lacs or such higher amount as may be prescribed, whichever is less, during the two immediately preceding financial years or in the current financial year;

(e) He must not either directly or any of his relatives :

   (i) hold or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed.

   (ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of –

      (A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

      (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

   (iii) holds together with his relatives two per cent or more of the total voting power of the company; or

   (iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives

25% or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company, then also he is not eligible for office of independent director; or

(f) who possesses such other qualifications as prescribed in Rule 5 of the Companies(Appointment and Qualification of Directors) Rules, 2014 as an independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.

Every listed public company shall have at least one-third of the total number of directors as independent directors (fraction is to be rounded off to one). Central Government has prescribed that public companies with paid up share capital of Rs. 10 crore or more; or turnover of Rs. 100 crore or more; or in aggregate, outstanding loans/ borrowings/ debentures/ deposits/ exceeding Rs. 50 crore or more as on the last date of latest audited financial statements mentioned below shall also have at least 2 directors as independent directors.

Further if there is any intermittent vacancy of an independent director then it shall be filled up by the board of directors within 3 months from the date of such vacancy or not later than immediate next board meeting, whichever is later.

Director elected by Small Shareholders

According to section 151 of the Companies Act, 2013 every listed company may have one director elected by such small shareholders. For the purpose of this section, "small shareholder" means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

Appointment of directors

First Director

The first directors of most of the companies are named in their articles. If they are not so named in the articles of a company, then subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed.

In the case of a One Person Company, an individual being a member shall be deemed to be its first director until the director(s) are duly appointed by the member in accordance with the provisions of Section 152 of the Companies Act, 2013.

General provisions relating to appointment of directors

1. Except as provided in the Act, every director shall be appointed by the company in general meeting.

2. Director Identification Number is compulsory for appointment of director of a company.

3. Every person proposed to be appointed as a director shall furnish his Director Identification Number and a declaration that he is not disqualified to become a director under the Act.

4. A person appointed as a director shall on or before the appointment give his consent to hold the office of director.

5. Articles of the Company may provide the provisions relating to retirement of the all directors. If there is no provision in the article, then not less than two-thirds of the total number of directors of a public company shall be persons whose period of office is liable to determination by retirement by rotation and eligible to be reappointed at annual general meeting.

At the annual general meeting of a public company one-third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither three nor a multiple of three, then, the number nearest to one-third, shall retire from office. The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment.

At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto. If the vacancy of the retiring director is not so filled-up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned till the same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a holiday, at the same time and place.

If at the adjourned meeting also, the vacancy of the retiring director is not filled up and that meeting also has not expressly resolved not to fill the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting, unless –

(i) a resolution for the re-appointment of such director has been put to the meeting and lost;

(ii) the retiring director has expressed his unwillingness to be so re-appointed;

(iii) he is not qualified or is disqualified for appointment;

(iv) a resolution, whether special or ordinary, is required for his appointment or re-appointment by virtue of any provisions of this Act; or

(v) appointment of directors to be voted individually is applicable to the case.

Duties of directors

As per Section 166 of the Companies Act, 2013, a director of a company shall:

– Act in accordance with the articles of the company.

– Act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

– Exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

– Not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

– Not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

– Not assign his office and any assignment so made shall be void.

If a director of the company contravenes the provisions of this section such director shall be punishable with fine which shall not be less than Rs. 1,00,000 but which may extend to Rs. 5,00,000.

Power of Board

Section 179 of the Companies Act, 2013 deals with the powers of the board; all powers to do such acts and things for which the company is authorised is vested with board of directors. But the board can act or do the things for which powers are vested with them and not with general meeting.

The following powers of the Board of directors shall be exercised only by means of resolutions passed at meetings of the Board, namely :-

(1) to make calls on shareholders in respect of money unpaid on their shares;

(2) to authorise buy-back of securities under section 68;

(3) to issue securities, including debentures, whether in or outside India;

(4) to borrow monies;

(5) to invest the funds of the company;

(6) to grant loans or give guarantee or provide security in respect of loans;

(7) to approve financial statement and the Board's report;

(8) to diversify the business of the company;

(9) to approve amalgamation, merger or reconstruction;

(10) to take over a company or acquire a controlling or substantial stake in another company;

(11) to make political contributions;

(12) to appoint or remove key managerial personnel (KMP);

(13) to take note of appointment(s) or removal(s) of one level below the Key Management Personnel;

(14) to appoint internal auditors and secretarial auditor;

(15) to take note of the disclosure of director's interest and shareholding;

(16) to buy, sell investments held by the company (other than trade investments), constituting five percent or more of the paid–up share capital and free reserves of the investee company;

(17) to invite or accept or renew public deposits and related matters;

(18) to review or change the terms and conditions of public deposit;

(19) to approve quarterly, half yearly and annual financial statements or financial results as the case may be.

Meetings of the Board

The way we run board meetings says much about how we run the company. Successful companies use board meetings to create and improve key business strategies.

The board of directors of a company is primarily an oversight board. It oversees the management of the company to ensure that the interest of non-controlling shareholders is protected. It also functions as advisory board. Independent directors bring diverse knowledge and expertise in the board room and the CEO uses the knowledge pool in addressing issues being faced by the company. The most important function of a monitoring board is to provide direction to the company. Another very important function of a monitoring board is to set the 'tone at the top'. It is expected to create the right culture within the company.

Section 173 of the Companies Act, 2013 deals with Meetings of the Board and it provides that the first Board meeting should be held within thirty days of the date of incorporation. In addition to the first meeting to be held within thirty days of the date of incorporation, there shall be minimum of four Board meetings every year and not more one hundred and twenty days shall intervene between two consecutive Board meetings.

In case of One Person Company (OPC), small company and dormant company, at least one Board meeting should be conducted in each half of the calendar year and the gap between two meetings should not be less than Ninety days. Directors may participate in the meeting either in person or through video conferencing or other audio visual means.

Notice of Board Meetings

The Companies Act, 2013 requires that not less than seven days' notice in writing shall be given to every director at the registered address as available with the company. The notice can be given by hand delivery or by post or by electronic means.

In case the Board meeting is called at shorter notice, at least one independent director shall be present at the meeting. If he is not present, then decision of the meeting shall be circulated to all directors and it shall be final only after ratification of decision by at least one Independent Director.

Quorum for Board Meetings

One third of total strength or two directors, whichever is higher, shall be the quorum for a meeting. If due to resignations or removal of director(s), the number of directors of the company is reduced below the quorum as fixed by the Articles of Association of the company, then, the continuing Directors may act for the purpose of increasing the number of Directors to that required for the quorum or for summoning a general meeting of the Company.

If at any time the number of interested directors exceeds or is equal to two-thirds of the total strength of the Board of directors, the number of directors who are not interested and present at the meeting, being not less than two shall be the quorum during such time.

The meeting shall be adjourned due to want of quorum, unless the articles provide shall be held to the same day at the same time and place in the next week or if the day is National Holiday, the next working day at the same time and place.

Key Managerial Personnel

The executive management of a company is responsible for the day to day management of a company. The companies Act, 2013 has used the term key management personnel to define the executive management. The key management personnel are the point of first contact between the company and its stakeholders. While the Board of Directors are responsible for providing the oversight, it is the key management personnel who are responsible for not just laying down the strategies as well as its implementation. Chapter XIII of the Companies Act, 2013 read with Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 deal with the legal and procedural aspects of appointment of Key Managerial Personnel including Managing Director, Whole-time Director or Manager, managerial remuneration, secretarial audit etc.

The Companies Act, 2013 has for the first time recognized the concept of Key Managerial Personnel. As per section 2(51) of the Companies Act, 2013 "key managerial personnel", in relation to a company, means—

(i) the Chief Executive Officer or the managing director or the manager;

(ii) the company secretary;

(iii) the whole-time director;

(iv) the Chief Financial Officer; and

(v) such other officer as may be prescribed.

Managing Director

Section 2(54) of the Companies Act, 2013, defines 'managing director'. It stipulates that a "managing director" means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

The explanation to section 2(54) excludes administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, from the substantial powers of management.

Whole Time Director

Section 2 (94) of the Companies Act, 2013 defines "whole-time director" as a director in the whole-time employment of the company.

Manager

Section 2(53) of the Companies Act, 2013 defines "manager" as an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.

Chief Executive Officer

Section 2(18) of the Companies Act, 2013 defined "Chief Executive Officer" means an officer of a company, who has been designated as such by it.

Chief Financial Officer

Section 2(19) of the Companies Act, 2013 defined "Chief Financial Officer" means a person appointed as Chief Financial Officer of a company.

Company Secretary

Section 2(24) of the Companies Act, 2013 defines "company secretary" or "secretary" means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act;

Appointment of Key Managerial Personnel

Section 203 of the Companies Act, 2013 read with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 mandates the appointment of Key Managerial Personnel and makes it obligatory for a listed company and every other public company having a paid up share capital of rupees ten crores or more, to appoint following whole-time key managerial personnel:

(i) managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;

(ii) company secretary; and

(iii) Chief Financial Officer:

Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration. An individual shall not be appointed or reappointed as the chairperson of the company, as well as the managing director or Chief Executive Officer of the company at the same time unless the articles of such a company provide otherwise; or the company does not carry multiple businesses. However, such class of companies engaged in multiple businesses and which has appointed one or more Chief Executive Officers for each such business as may be notified by the Central Government are exempted from the above.

A whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time. However, he can hold such other directorship with the permission of the Board.

A whole-time key managerial personnel holding office in more than one company at the same time, shall, within a period of six months from such commencement, choose one company, in which he wishes to continue to hold the office of key managerial personnel.

A company may appoint or employ a person as its managing director, if he is the managing director or manager of one, and of not more than one, other company and such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting and of which meeting, and of the resolution to be moved thereat, specific notice has been given to all the directors then in India.

If the office of any whole-time key managerial personnel is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.

Appointment of Whole-Time Company Secretary

As per Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 provides that a company which has a paid up capital of Five crore rupees or more shall have a whole-time company secretary.

Functions of Company Secretary

According to Section 205 of the Companies Act, 2013 the functions of the company secretary shall include,—

(a) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;

(b) to ensure that the company complies with the applicable secretarial standards;

(c) to discharge such other duties as may be prescribed.

Explanation.—For the purpose of this section, the expression “secretarial standards” means secretarial standards issued by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 and approved by the Central Government.

For the purposes of clause (c) of sub-section (1) of section 205, the Central Government has prescribed that the duties of Company Secretary shall also include –

(1) to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;

(2) to facilitate the convening of meetings and attend Board, committee and general meetings, and maintain the minutes of these meetings;

(3) to obtain approvals from the Board, general meetings, the Government and such other authorities as required under the provisions of the Act;

(4) to represent before various regulators, Tribunal and other authorities under the Act in connection with discharge of various functions under the Act;

(5) to assist the Board in the conduct of the affairs of the company;

(6) to assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices; and

(7) to discharge such other duties as may be assigned by the Board from time to time;

(8) such other duties as have been prescribed under the Act and Rules.

Section 205(2) of the Companies Act, 2013 provides that provisions contained in section 204 and section 205 shall not affect the duties and functions of the Board of Directors, chairperson of the company, managing director or wholetime director under this Act, or any other law for the time being in force.

Role of Secretary in a Company

Generally speaking, the role of a secretary is threefold, viz., as a statutory officer/Key Managerial Personnel, as a co-ordinator and as an administrative officer. Similarly, the responsibility of a company secretary extends not only to the company, but also to its shareholders, depositors, creditors, employees, consumers, society and the Government.

Thus a company secretary plays a vital role in company administration. His role can conveniently be studied from three different angles:

(a) as a statutory officer/key managerial personnel ;

(b) as a coordinator;

(c) as an administrative officer.

(a) Statutory Officer/Key Managerial Personnel

According to Section 203 of the Companies Act, 2013 read with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 mandates the appointment of Key Managerial Personnel and makes it obligatory for a listed company and every other public company having a paid up share capital of rupees ten crores or more, to appoint following whole-time key managerial personnel:

(i) managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;

(ii) company secretary; and

(iii) Chief Financial Officer:

As per Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 provides that a company which has a paid up capital of Five crore rupees or more shall have a whole-time company secretary.

Under the Indian Stamp Act, it is the duty of a Secretary to see that the documents such as letter of allotment, share certificate, debentures, mortgages are issued duly stamped. He is the principal officer under Section 2(35) of the Income-tax Act, 1961.

Thus, the responsibility of a secretary as a statutory officer has been expanded by the enactment of various economic legislations, like Industries (Development and Regulation) Act; Foreign Exchange Management Act and Competition Act etc. Accordingly, the numerous provisions which the company is obliged to comply with makes the Secretary's job onerous and difficult. The duties imposed upon a secretary by various statutes clearly indicates the important place that he occupies in corporate administrative hierarchy.

(b) Co-ordinator

The Company Secretary as a co-ordinator has an important role to play in the administration of a company's business and affairs. It is for the secretary to ensure effective execution and implementation of the management policies laid out by the Board. The position that the Company Secretary occupies in the administrative set up of the Company makes his function as one of co-ordinator and link between the top management and other levels. He is not only the communicating channel between the Board and the executives but he also co-ordinates the actions of other executives vis-a-vis the Board. The ambit of his role as a co-ordinator also extends beyond the company and he is the link between the company, its shareholders, society and the Government. Thus, the role of a company secretary as a co-ordinator has two aspects, namely internal and external. The internal role of a co-ordinator extends to the Board including the Chairman and Managing Director, various line and staff functions, the trade unions and the auditors of the company. His role as an external co-ordinator extends to the relationship of the company with shareholders, Government and Society.

Where, the company has a Managing Director, he must seek his guidance and instructions regarding implementation of the policies laid down by the Board and also on matters arising out of the implementation of the decisions. He is also required to keep the chairman and the managing director apprised of changes made in the Government Policies/Acts, obligations under various statues and to give balanced advice on matters which have legal ramifications.

Relationship with other Functionaries

We have seen that the Secretary is responsible for conveying the Board’s decisions on various aspects of the company’s policies to the persons incharge of such functions. He is, in addition, responsible to ensure that the returns and reports received from various operational executives are submitted in time complete in all respects, and do not conflict with the corporate objectives.

Even where different persons are in-charge of other functions, e.g., sales, personnel, etc., it is usually the Secretary who normally communicates with outside agencies, particularly with government and semi-government bodies to ensure that the information given to various agencies do not conflict with each other and are in accordance with the statutory requirements and corporate objectives of the organisation.

Trade Union

Where the Secretary is responsible either directly or through his assistants for industrial relations, he must be very careful with trade union officials whether they belong to recognised unions or not. He must ensure that proper notes are kept of the discussions and negotiations and all decisions arrived at during such negotiations.

Whenever long term settlement with recognised unions is finalised he should see that the agreement embodying these settlements are in accordance with the relevant statutes applicable. It is the responsibility of the Secretary to ensure compliance with the provisions of various labour legislations such as Industrial Disputes Act, 1947, Employees’ Provident Funds and Miscellaneous Provisions Act, 1952, Payment of Bonus Act, 1965, Payment of Gratuity Act, 1972, Payment of Wages Act, 1936, etc. Whilst he must ensure that the employees guilty of misconduct are charge-sheeted and punished but before doing so all formalities, e.g., holding of enquiries, etc., must be scrupulously followed. He should see that industrial labour relations are always cordial and he should ensure that various creative activities of the employees are encouraged wherever possible by grants and subsidies from the company.

Shareholders

The relationship with the shareholders is an important sphere of his co-ordinating role and, therefore, the Secretary will have to maintain proper relationship with the shareholders of the company. He should ensure that there is no delay in the inspection of books and registers required by a shareholder provided all formalities are complied with. He must ensure that extracts of registers demanded by shareholders are furnished to them within the statutory periods.

However, the most important thing for a Secretary is to ensure that all correspondence from shareholders is dealt with promptly, and their queries are answered as far as possible keeping the statutory provisions in mind. As part of public relations he should be able to attend to the shareholders who personally come for information, to furnish documents or details or any other matter as the image of the company will, to a great extent, depend on the relationship of the Secretary with the shareholders.

Government

All information and correspondence with the Government are normally coordinated or routed through the Secretary to ensure uniform reporting. The Secretary has a very important role vis-a-vis the Government. He should endeavour to have information on Government policies and programmes in advance wherever possible to ensure effective implementation. Good relationship with the Government can be developed where the company sincerely tried to implement various statues both in law and spirit.

Community

In recent years the responsibility of a company towards society has become very important since the company has to function within the parameters of the environment of the country. With this in view, a number of companies have undertaken rural development including adoption of villages and have built schools, colleges and hospitals to cater to the needs of society. In respect of companies in consumer goods industry, it is necessary to project that the products and their prices are in consonance with the standards expected by the consumers. Arising out of such social responsibility many companies have also allowed small sectors to manufacture ancillaries and raw materials required by the organisation for promotion of employment opportunities.

(c) Administrative Officer

The principal duty of a secretary as an administrator is to ensure that the activities of a company are in conformity with the company's policy. In his role as an administrator, the secretary provides the very foundation on which the entire structure of company administration is constructed. The role of company secretary can be subdivided into organisational, financial, office and personnel administration.

Organisational Administration

Since the secretary has an opportunity of looking at the entire organisation with some amount of detachment, he has the scope to advise the top management including the Board of directors on the need to develop a good structure. Since the secretary collects, interprets and assimilates information relating to all aspects of business to aid and assist the board in carrying out its function, he therefore, gets an opportunity to know the strengths and the weaknesses of the functional executives.

In his role as administrator, he has to make a detailed analysis of various activities, decision-making machinery, inter-relations of departments and functions. He has, therefore, to ensure that the organisational structure must always be kept under constant study. The making of such examination and study and the consequent advice and recommendation for making changes is a task which the company secretary has to perform.

Financial Administration

Since various monthly and periodical operating reports and financial statements are routed for consideration of the board through the secretary, he should analytically study these statements. Thus as a secretary to the Board, the Company Secretary has in consultation with the Chief Finance Officer to devise suitable and proper systems of accounting procedure, internal control and internal audit with a view to safeguard the company's funds. The Company Secretary should have a good knowledge of budgetary control and procedures, accounts and other related matters. He is also expected to be proficient in dealing with matters connected with taxation.

The Company Secretary is generally assisted by Chief Finance Officer in the discharge of his functions relating to financial administration. In many companies, the Secretary is also the Chief Finance Officer. He has to negotiate with banks and financial institutions the terms of finance both for working capital requirements and capital expenditure.

Office Administration

In all big companies, the office administration is carried on by an officer called the Office Manager who generally reports to the Company Secretary. It is the duty of the Secretary to ensure that different departments of the office are properly staffed, organised, co-ordinated and supervised. He has to review from time to time, the various procedures and systems with a view to making the administration effective. In the discharge of these functions, he is normally assisted by organisation methods section of the organisation. He is also responsible in most organisations for office services including transport. The image of a company depends on the design and office layout from the reception to the records. The Secretary has not only to ensure that these services are maintained and increased but also to ensure that the cost of such services is reviewed from time to time.

Personnel Administration

Personnel Administration includes recruitment, training, payment, promotion, retirement, discharge and dismissal of staff. This is a very important and at the same time a difficult task to administer. Whilst in big organisations there may be a separate personnel manager or officer, in smaller companies the Secretary may be called upon to advise and assist the directors on principles and legal points involved in this area of administration.

Administration - Company's Properties

The Secretary has an important role to play in safeguarding the company's interest in property matters, ensure all properties are properly maintained and insured and keep a suitable register for each property containing relevant information. He should have a good knowledge of relevant rules and by-laws applicable to property. He should also ensure that registration of trade marks, patents, licences is done from time to time and legal action is taken in respect of infringement of such industrial rights.

Corporate Records

The secretary is required to maintain certain records in addition to those under the Companies Act. The volume, the method and the procedure will vary with the size and nature of the company. The secretary has also to ensure that the statutory time limits relating to directors and shareholders meetings, payment of dividend and interest, filing of returns under the Companies Act, 2013, Income-tax Act, etc., are adhered to and formalities under stock exchange regulations are compiled with. He must also ensure timely renewal of contracts and leases.

Personnel and Property

The secretary has to ensure that adequate system of security of personnel based on technical advice are available in the factory and office. He is also responsible for devising and maintenance of systems to safeguard the valuable company records, or information against loss, theft, fire, etc. He is to review from time to time to ensure that the properties of the company are adequately insured. The company secretary should have good knowledge of insurance law and practice.

Whilst the above discussion only gives a brief outline, the duties and responsibilities of the company secretary are subject to continuous change and has, therefore, to be reviewed from time to time to ensure that he effectively contributes in respect of the above matters. He should, therefore, keep himself abreast of legal changes and practice.

Members' Meetings

A company is composed of members, though it has its own entity distinct from members. The members of a company are the persons who, for the time being, constitute the company, as a corporate entity. However, a company, being an artificial person, cannot act on its own. It, therefore, expresses its will or takes its decisions through resolutions passed at validly held Meetings. The primary purpose of a Meeting is to ensure that a company gives reasonable and fair opportunity to those entitled to participate in the Meeting to take decisions as per the prescribed procedures.

The decision making powers of a company are vested in the Members and the Directors and they exercise their respective powers through Resolutions passed by them. General Meetings of the Members provide a platform to express their will in regard to the management of the affairs of the company.

Convening of one such meeting every year is compulsory. Holding of more general meetings is left to the choice of the management or to a given percentage of shareholders to exercise their power to compel the company to convene a meeting. Shareholder Democracy, Class Action Suits and Protection of interest of investors are the essence and attributes of the Companies Act, 2013.

A company is required to hold meetings of the members to take approval of certain business items, as prescribed in the Act. The meetings to be held for seeking approval to ordinary business and special business are called annual general meeting and extraordinary general meeting. In certain cases, a company may have to hold a meeting of the members of a particular class of members.

Members' Meetings are:

– Annual General Meeting

– Extraordinary General Meeting

– Class Meeting

Annual General Meeting

Annual general meeting (AGM) is an important annual event where members get an opportunity to discuss the activities of the company. Section 96 of the Companies Act, 2013 provides that every company, other than a one person company is required to hold an annual general meeting every year.

Following are the key provisions regarding the holding of an annual general meeting:

Holding of annual general meeting

1. Annual general meeting should be held once every year.
2. First annual general meeting of the company should be held within 9 months from the closing of the first financial year. Hence it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation.
3. Subsequent annual general meeting of the company should be held within 6 months from the closing of the financial year.
4. The gap between two annual general meetings should not exceed 15 months.

Extension of validity period of AGM

In case, it is not possible for a company to hold an annual general meeting within the prescribed time, the Registrar may, for any special reason, extend the time within which any annual general meeting shall be held. Such extension can be for a period not exceeding 3 months. No such extension of time can be granted by the Registrar for the holding of the first annual general meeting,

Time and place for holding an annual general meeting

An annual general meeting can be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday. It should be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situate. The Central Government is empowered to exempt any company from these provisions, subject to such conditions as it may impose.

"National Holiday" for this purpose means and includes a day declared as National Holiday by the Central Government.

Default in holding the annual general meeting

Section 99 of the Companies Act, 2013 provides that if any default is made in complying or holding a meeting of the company, the company and every officer of the company who is in default shall be punishable with fine which may extend to Rs. 1 lakh and in case of continuing default, with a further fine which may extend to Rs. 5,000/- for each day during which such default continues. If any default is made in holding the annual general meeting of a company, any member of the company may make an application to the Tribunal to call or direct the calling of, an annual general meeting of the company and give such ancillary or consequential directions as the Tribunal thinks expedient. Such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

Business to be transacted at annual general meeting:

Sub-section (2) of Section 102 of the Companies Act, 2013 provides that all other businesses transacted at an Annual General Meeting except the following are special business:

(i) the consideration of financial statements and the reports of the Board of Directors and auditors;

(ii) the declaration of any dividend;

(iii) the appointment of directors in place of those retiring;

(iv) the appointment of, and the fixing of the remuneration of, the auditors.

Extra Ordinary General Meeting

All general meetings other than annual general meetings are called extraordinary general meetings. Extraordinary General Meetings shall called by:

– By Board

– By Board on requisition of shareholders

– By requisitionists

– By Tribunal

All businesses items can be transacted at the extraordinary general meetings are special business. Following are the key provisions, provided in section 100, regarding calling and holding of an extraordinary general meeting:

(I) *By Board*

The Board may, whenever it deems fit, call an extraordinary general meeting of the company.

(II) *By Board on requisition of shareholders*

The Board must call an extraordinary general meeting on receipt of the requisition from the following number of members:

(a) in the case of a company having a share capital: members who hold, on the date of the receipt of the requisition, not less than one-tenth of such of the paid-up share capital of the company as on that date carries the right of voting;

(b) in the case of a company not having a share capital: members who have, on the date of receipt of the requisition, not less than one-tenth of the total voting power of all the members having on the said date a right to vote.

The requisition should set out the matters to be considered at the proposed meeting and the same should be signed by the requisitionists and sent to the registered office of the company. The Board must, within 21 days from the date of receipt of a valid requisition, proceed to call a meeting on a day not later than 45 days from the date of receipt of such requisition.

(III) *By requisitionists*

If the Board does not within 21 days from the date of receipt of a valid requisition in regard to any matter, proceed to call a meeting for the consideration of that matter on a day not later than 45 days from the date of receipt of such requisition, the meeting may be called and held by the requisitonists themselves.

However in such case, the meeting should be held within a period of 3 months from the date of the requisition. Reasonable expenses incurred by the requisitionists in calling such a meeting shall be reimbursed by the company to the requisitionists. The company in turn recover such expenses from any fee or other remuneration under section 197 payable to such of the directors who were in default in calling the meeting. In case, the quorum is not present within half-an-hour from the time appointed for holding a meeting called by requisitionists, the meeting shall stand cancelled.

(IV) *By Tribunal*

Section 98 of the Companies Act, 2013 provides that if for any reason it is impracticable to call a meeting of a company or to hold or conduct the meeting of the company, the Tribunal may, either suo motu or on the application of any director or member of the company who would be entitled to vote at the meeting:

Order a meeting of the company to be called, held and conducted in such manner as the Tribunal thinks fit; and

Give such ancillary or consequential directions as the Tribunal thinks expedient, including directions modifying or supplementing in relation to the calling, holding and conducting of the meeting, the operation of the provisions of this Act or articles of the company. Such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting. Meeting held pursuant to such order shall be deemed to be a meeting of the company duly called, held and conducted.

Notice of Meeting

A general meeting of a company may be called by giving not less than 21 clear days' notice either in writing or through electronic mode. Notice through electronic mode shall be given in such manner as may be prescribed.

Short notice

A general meeting may be called after giving a shorter notice also if consent is given in writing or by electronic mode by not less than 95% of the members entitled to vote at such meeting.

Contents of Notice

Place of meeting

The notice should state the place where the general meeting is scheduled to be held. In case of an annual general meeting, the place of the meeting has to be either the registered office of the company or some other place within the city, town or village in which the registered office of the company is situated. No such restriction applies to an extraordinary general meeting.

Day of meeting

The day and date of the meeting should be clearly stated in the notice. In case of an annual general meeting, the day should be one that is not a National Holiday. An extraordinary general meeting can however be held on any day.

Time of meeting

Exact time of holding the meeting should be given in the notice. An annual general meeting can be called during business hours only, that is, between 9 a.m. and 6 p.m. There is no need to follow such timings in case of an extraordinary general meeting.

Agenda

A statement of the business to be transacted at the general meeting should be given in the notice. In case, the meeting is to transact a special business, a explanatory statement should be attached about such item.

Proxy clause with reasonable prominence

Every notice calling a meeting of a company which has a share capital, or the articles of which provide for voting by proxy at the meeting, should carry with reasonable prominence, a statement that a member entitled to attend and vote is entitled to appoint a proxy, or, where that is allowed, one or more proxies, to attend and vote instead of himself, and that a proxy need not be a member.

Notice through Electronic Mode

A company may give notice through electronic mode. Electronic mode' means any communication sent by a company through its authorized and secured computer programme which is capable of producing confirmation and keeping record of such communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the member.

Class Meetings

Class meetings are those meetings which are held by holders of a particulars class of shares/ debenture holders/ creditors.

E-GOVERNANCE

With the advent of Information and Communication Technology in all sectors today, Governments across the globe are taking major initiatives to integrate IT in all their processes. These initiatives aimed at electronic governance, embrace policy changes, legal reforms, business process reengineering, change management and infrastructure creation. They are also realizing that public/private partnership is very critical to the success of any e- governance Project and are accordingly entering into partnerships with private IT companies to implement e-governance. It is being felt that IT enablement of various Government to Business processes along with Business Process Reengineering will not only improve efficiency and transparency of the government operations, but will also provide speedy transactions between the government and the businesses.

E-GOVERNANCE AND MCA-21

Electronic Governance is the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance. E-governance is a highly complex process requiring provision of hardware, software, networking and re-engineering of the procedures for better delivery of services.

MCA-21 is an ambitious e-governance initiative of Government of India that builds on the Government's vision of National e-governance in the country. As part of the Government's focus on governance norms to meet the expectations arising from globalization, MCA project was launched as a flagship initiative of Ministry of Corporate Affairs (MCA). The project was named MCA 21 as it aimed at repositioning MCA as an organization capable of fulfilling the aspirations of its stakeholders in the 21st Century. Rather than compelling the business community to physically travel to MCA offices, MCA services are made available at the place of their choice, be it their homes or offices. The scope of MCA 21 includes services provided by the Regional Directors (RDs), Offices of Registrar of Companies (ROCs) and the Ministry Headquarters etc . MCA 21 fully automates all processes related to the proactive enforcement and compliance of the legal requirements under the Companies Act, 2013. E-filing facility includes incorporation of new companies, filing annual return and other statutory returns, registration and verification of charges and processing of various approvals/ clearances etc. applied on time. Besides, inspection of company documents, request for certified copies is also facilitated through MCA portal.

LESSON ROUND UP

– A company, though a legal entity in the eyes of law, is an artificial person, existing only in contemplation of law. It has no physical existence. It has neither soul nor body of its own. As such, it cannot act in its own person. It can do so only through some human agency.

– The persons who are in charge of the management of the affairs of a company are termed as directors. They are collectively known as Board of Directors or the Board. The directors are the brain of a company.

– Section 149(1) of the Companies Act, 2013 requires that every company shall have a minimum number of 3 directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company.

– Every company shall have a minimum number of 3 directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company.

– As per Section 165 of the Companies Act, 2013, maximum number of directorships, including any alternate directorship a person can hold is 20.

– Every listed company shall appoint at least one woman director and every other public company having paid up share capital of Rs. 100 crores or more or turnover of Rs. 300 crore or more as on the last date of latest audited financial statements, shall also appoint at least one woman director.

– Every listed company may have one director elected by small shareholders.

– The first Board meeting should be held within thirty days of the date of incorporation. In addition to the first meeting to be held within thirty days of the date of incorporation, there shall be minimum of four Board meetings every year and not more one hundred and twenty days shall intervene between two consecutive Board meetings.

– Section 203 of the Companies Act, 2013 read with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 mandates the appointment of Key Managerial Personnel and makes it obligatory for a listed company and every other public company having a paid up share capital of rupees ten crores or more, to appoint following whole-time key managerial personnel:(i) managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;(ii) company secretary; and (iii) Chief Financial Officer:

– As per Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 provides that a company which has a paid up capital of Five crore rupees or more shall have a whole-time company secretary.

– Annual general meeting (AGM) is an important annual event where members get an opportunity to discuss the activities of the company. Section 96 of the Companies Act, 2013 provides that every company, other than a one person company is required to hold an annual general meeting every year.

– All general meetings other than annual general meetings are called extraordinary general meetings. Extraordinary General Meetings shall called by Board; by Board on requisition of shareholders; by requisitionists ; by Tribunal.

– Electronic Governance is the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance.

GLOSSARY

"Board of Directors" or "Board"	The collective body of the directors of the company.
"Director"	A director appointed to the Board of a company.
"Independent director"	An independent director referred to in sub section (5) of section 149 of the Companies Act, 2013.
"Small shareholder"	A shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.
"Key Managerial Personnel"	Key Managerial Personnel in relation to a company, means— (i) the Chief Executive Officer or the managing director or the manager;(ii) the company secretary;(iii) the whole-time director;(iv) the Chief Financial Officer; and (v) such other officer as may be prescribed.
"Managing Director"	A director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.
Whole-Time Director	A director in the whole-time employment of the company.
"Manager"	An individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.
"Chief Executive Officer"	An officer of a company, who has been designated as such by it.
"Company Secretary" or "Secretary"	A company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act;

SELF-TEST QUESTIONS

1. Define Director and Board of Director.
2. Write short notes on:
   (a) Key Managerial Personnel
   (b) Whole-time Director
   (c) Company Secretary.
3. How are the first directors of a company appointed?
4. Discuss duties of Board of Director of a company.
6. Enumerate the powers to be exercised by the Board only at their meetings.
7. Discuss the function of the Company Secretary.
8. Enumerate briefly the duties of a Company Secretary.
9. What is a statutory meeting? State the contents of Statutory Report.
10. What is an Extraordinary General Meeting? Who can call such a meeting?

Lesson 9
Indian Partnership Act, 1932

LESSON OUTLINE

- Nature of Partnership
- Essentials of a Partnership and True Test of Partnership
- Classification of Partnership
- Kinds of Partners
  - Actual, Active or Ostensible Partner
  - Sleeping or Dormant Partner
  - Nominal Partner
  - Partner in Profits Only
  - Sub-Partner
  - Partner by Estoppel or Holding Out
- Review Questions
- Minor Admitted to the Benefits of Partnership
- Rights and Duties of Partners
- Relation of Partners to Third Parties
- Dissolution of Partnership
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

Likewise corporations which are regulated by Companies Act, 2013, the other form of business is partnership which is regulated by Indian Partnership Act, 1932. The partnership is considered as the convenient way to start a business. Suppose one wants to open a bookshop in the locality. There are various things that are required to start and run the business which may not be feasible to arrange all alone. These may include resources from money to place to management. In that case, the idea may be spoken to friends and relatives who may agree to run the bookshop by contributing a certain amount of money and other things required. So all of them join hands together to become the owners and agree to share profits and losses.

This chapter deals with laws relating to partnership that will regulate this form of business, its registration, admission of new partners, and dissolution. It also explains other aspects of partnership like kinds of partners, relationship among themselves and with others.

There's an assumption by many partners that no matter what happens to their business, they'll be partners forever.

David Gibbs

INTRODUCTION

The Indian Partnership Act, 1932, came into force w.e.f. 1^{st} October, 1932 except section 69, which came into force on the 1^{st} day of October, 1933. It extends to the whole of India except the state of Jammu and Kashmir.

It lays down the important provisions relating to partnership contracts. However, the general principles of the Indian Contracts Act, 1872 which formally contained the provisions of the law of partnership shall apply so far as they are not inconsistent with this Act. (Section 3)

DEFINITIONS

Partnership

According to Section 4 “Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all”.

When analysed, the definition tells us that in order that persons may become partners, it is essential that:

(1) There must be at least two persons

(2) There must be a relationship arising out of an agreement between two or more persons to do a business

(3) The agreement must be to share the profits of a business

(4) The business must be carried on by all or any of them acting for all

All these four elements must be present before a group or an association can be held to be partners. In other words, it can be said that all the aforestated four elements must co-exist before a partnership can be said to come into existence. If any one of them is not proved to be present, there cannot be a partnership. The first element relates to the voluntary contractual nature of partnership; the second gives the motive which leads to the formation of firms, i.e. the acquisition of gains; the third shows that the persons of the group who conduct the business do so as agents for all the persons in the group, and are therefore liable to account to all the persons in the group (*Maliram Choudhary* v. *Jagannath,* AIR 1972 Orissa 17).

Partners, Firm and Firm Name

Persons who have entered into partnership with one another are called individually “partners” and collectively “a firm”, and the name under which their business is carried on is called the “firm name”. (Section 4)

In law, “a firm” is only a convenient phrase for describing the partners, and the firm has no legal existence apart from its partners. It is neither a legal entity, nor it is a person as is a corporation; it is only a collective name of the members of a partnership.

As regard the “firm name”, partners have a right to carry on business under any name and style which they choose to adopt, provided they do not violate the rules relating to trade name or goodwill. They must not adopt name calculated to mislead the public into confusing them with a firm of repute already in existence with a similar name. They must not use a name implying the sanction of patronage of the Government. A partnership firm cannot use the word “Limited” as a part of its name.

Essentials of a Partnership and True Test of Partnership

These elements are discussed below in detail:

(i) ***Association of two or more Persons:*** There must be a contract between two or more persons. Therefore unless there are at least two persons there can not be a partnership. Persons must be competent to enter into a contract. They may all be natural or artificial or some natural and other artificial. Thus a corporation or limited partnership may itself be a partner in a general partnership if provided by their articles.

(ii) *Agreement:* Existence of an agreement is essential of partnership. Section 5 of the Act states that the relation of partnership arises from contract and not from status; and in particular, the members of a Hindu Undivided Family carrying on a family business as such, or a Burmese Buddhist Husband and wife carrying on business as such are not partners in such business.

Such an agreement between the partners may be express or implied. Further, the agreement must be a valid agreement and for a lawful object and purpose and between the persons competent to contract.

(iii) *Business:* Partnership implies business and when there is no association to carry on business there is no partnership. The term "business" is, however, used in the widest sense to cover trade, occupation and profession. As per Section 2(b) of the Act the term "business" includes every trade, occupation and profession. In the definition of partnership the word "business" is used in the sense of "carrying on business" which suggests continuity or repetition of acts. But it does not mean that it should be confined to lengthy operations, it may consist of a single adventure of a single undertaking, if there is continued participation of two or more persons for acquisition of gains.

The term must be understood in a particular sense . It refers to any activity which, if successful, would result in profit. The business must be lawful.

(iv) *Sharing of Profits:* To constitute a partnership, the parties must have agreed to carry on a business and to share profits in common. "Profits" mean the excess of returns over advances, the excess of what is obtained over the cost of obtaining it. Sharing of profits also involves sharing of losses. But whereas the sharing of profit is an essential element of partnership, the sharing of losses is not. It is open to one or more partners to bear all the losses of the business as decided by the agreement among them.

It follows that the sharing of profits is an essential ingredient of partnership and there would be no partnership where only one of the partners is entitled to the whole of the profits of the business. But it is open to the partners to agree to share the profits in any way they like. They may agree to share the profits either in specific proportions or in specific sums.

Sharing of Profits is not Conclusive Test : Although sharing of profits is a prima facie evidence of the existence of partnership, this is not the conclusive test of the same. A person may have a share in the partnership profits, but still may not be a partner. For instance, a joint owner of a property sharing its return or members of non-profit or non-trading associations will not be called partners. Similarly, a servant or agent who receive a share in profits as his remuneration or the seller of goodwill are not by reason of such facts alone, partners.

Illustrations

1. A and B buy 100 bales of cotton, which they agree to sell for their joint account, each party sharing profits and bearing losses equally. A and B are partners in respect of such account.
2. A and B buy 100 bales of cotton agreeing to divide these between them. A and B are not partners.
3. "A" a trader, owed money to XY&Z. He agreed to pay XY&Z out of the profits of his business (run under the supervision of X, Y and Z) what he owned to them. It was held that the arrangement does not make X, Y and Z the partners with A in the business.

(v) *Mutual Agency the True Test:* Mutual agency is the foundation of partner's liability. Each partner is both an agent and principal for himself and others; that is the significance of the phrase "carried on by all or any of them acting for all". Each partner is an agent binding the other partners who are his principal and each partner is again a principal, who in turn is bound by the acts of the other partners. In other words, there must be facts or circumstances from which it can be inferred that each of the persons alleged to be partners was the agent, real or implied of another. What is essential is that the partner who conducts the business of the firm not only acts for himself but for the other partners also.

The true test, therefore, in determining whether a partnership exists, is to see whether the relation of principal and agent exists between the parties and not merely whether the parties share the profits or the business is carried on for the benefit of all. It is this relation of agency among partners which distinguishes a partnership from a single co-ownership on the one hand and the agreement to share profits on the other. The existence of this relation of agency can be gathered from the real intention of the parties and the circumstances of the case. The question of intention must be decided on the basis of the conduct of parties and of all the surrounding circumstances. The law of partnership is the extention of the law of agency therefore every partner is liable for the act of other partner if within authority upto unlimited extent. The relation of mutual agency is the conclusive test of partnership.

It may be observed that the question whether a person is or is not a partner depends almost in all cases upon whether he has the authority to act for other partners and whether other partners have the authority to act for him. It follows that the agency relationship is the most important test of partnership.

Formation of Partnership

According to the definition of partnership under the Indian Partnership Act, 1932, there must be an agreement between the partners of a partnership firm. Thus, partnership arises by the contract.

The partnership agreement must comply with all the essentials of a valid contract. There must be free consent of the parties who must be competent to contract and the object of partnership should not be forbidden by law or immoral or opposed to public policy. Two exceptions, however, may be noted:

(i) A minor may be admitted to the benefits of an existing partnership firm with the **consent of all** other partners.

(ii) As relations of partners inter se are that of agency, **no consideration** is required to create the partnership.

Partnership Deed

The agreement of partnership may be oral but to avoid future disputes it is always advisable to have it in writing. The mutual rights and obligations of partners must be discussed in detail and should be put into writing in the shape of a ‘Partnership Deed’, before the partnership is actually started. Thus, the written document which contains the mutual rights and obligations of partners is known as partnership deed. (The partnership deed is also called as ‘Partnership Agreement’, ‘Constitution of Partnership’, ‘Articles of Partnership’ etc.). The deed must be property drafted and stamped according to the provisions of the Indian Stamp Act. Each partner should be given a copy of the deed and if the firm is to be registered, a copy of the deed should be filed with the Registrar of Firms at the time of such legislation. The partnership deed is not a public document and therefore binds only third parties so far as they have notice of it.

Contents of Partnership Deed

The exact terms of the partnership deed (or agreement) will depend upon the circumstances but generally a partnership deed contains the following covenants:

(i) The firm name and business to be carried on under that name.

(ii) Names and addresses of partners.

(iii) Nature and scope of business and address(s) of business place(s).

(iv) Commencement and duration of partnership.

(v) The capital and the contribution made by each partner.

(vi) Provision for further capital and loans by partners to the firm.

(vii) Partner's drawings.

(viii) Interest on capital, loans, drawings and current account.

(ix) Salaries, commission and remuneration to partners,

(x) Profit (or loss) sharing ratio of partners.

(xi) The keeping of proper books of accounts, inspection and audit, Bank Accounts and their operation.

(xii) The accounting period and the date on which that accounts are to be prepared.

(xiii) Rights, powers and duties of the partners.

(xiv) Whether and in what circumstances, notice of retirement or dissolution can be given by a partner.

(xv) Provision that death or retirement of a partner will not bring about dissolution of partnership,

(xvi) Valuation of goodwill on retirement, death, dissolution etc.

(xvii) The method of valuation of assets (and liabilities) on retirement or death of any partner.

(xviii) Provision for expulsion of a partner.

(xix) Provision regarding the allocation of business activities to be performed by individual partners

(xx) The arbitration clause for the settlement of disputes. The terms contained in the partnership deed may be varied with the consent of all the parties, and such consent may be express or implied by a course of dealing. [Section 11(1)]

CLASSIFICATION OF PARTNERSHIP

A partnership may either be for a particular adventure or for a fixed period. It may also be a partnership at will. From the duration point of view, a partnership may be classified into the following two categories:

(i) Particular Partnership (Section 8)

"A person may become a partner with another person in a particular adventure or undertaking or for a particular period". When two or more persons agree to do business in a particular adventure or undertaking or for a particular period, such a partnership is called "Particular Partnership". Thus, a particular partnership may even be for a single adventure or undertaking.

(ii) Partnership at Will (Section 7)

"Where no provision is made by contract between the partners for the duration of their partnership or for the determination of their partnership, the partnership is called Partnership at Will". A partnership is deemed to be a partnership at will when (i) no fixed period has been agreed upon for the duration of partnership, and (ii) there is no provision made as to the determination of partnership in any other way. The partnership at will has no fixed or definite date of termination and, therefore, death or retirement of a partner does not affect the existence of such partnership.

Section 43(1) provides that "Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm. The firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no such date is mentioned, as from the date of communication of the notice". This accounts for the importance of the definition of 'Partnership at Will'.

Co-ownership and Partnership

There is a possibility that two co-owners may employ their property in a business and share the profits, and still be not partners. A distinction between the two is in point. Partnership is between two persons, co-ownership may have two or any number more than two. Co- ownership is not always the result of an agreement: it may arise by the operation of law or from status, e.g., co-heirs of a property. Partnership must arise from an agreement. A partner is the agent of the other partners, but a co-owner is not the agent of the other co-owner(s). Co-ownership does not necessarily involve community of profits and loss, partnership does. A co-owner can transfer his rights and interests to strangers without the consent of the others, a partner cannot do so without the consent of all the other partners so as to make the transferee a partner in the firm. A co-owner can ask for division of property in specie, but no partner can ask for this. His only right is to have a share of the profits out of the properties. A co-owner has no lien on the property while a partner has a lien on the firm property.

Hindu Joint Family Firm and Partnership

A Hindu joint family firm differs from a partnership in the following ways:

A partnership comes into existence by means of a contract between the partners; a Hindu joint family firm arises as a result of status, i.e., by birth in the family. The death of a partner dissolves the partnership, but the death of a co-parcener does not dissolve the family firm. In a joint family firm only the Karta or manager (who is the head of the family) has implied authority to borrow and bind other members; in a partnership each partner is entitled to do so. Every partner is personally liable for the debts of the firm; in a joint family business only the Karta is personally liable. A minor is a member of a joint family firm from the very day of his birth by virtue of his status, but he is not personally liable. A minor cannot be a partner, although he may be admitted to the benefits of partnership. A partner can demand the accounts of the firm, a co-parcener cannot ask for accounts, his only remedy is to ask for partition of the assets of the family firm. No registration of a family firm is necessary, while a partnership firm must be registered before it can maintain suits against outsiders. Each partner has a definite share in the business and this can be changed only by agreement, but the share of a co-parcener is not fixed; it may be enlarged by death or reduced by a birth in the family. There is a definite limit to the number of partners, but there is no such limit in the case of a Hindu joint family firm. A Hindu joint family business is governed by Hindu Law, while Indian Partnership Act, governs partnerships and excludes Hindu joint family firms. (Section 5)

Company and Partnership

The members constituting a partnership do not form a whole as distinct from the individuals composing it. The firm has no legal entity and has no rights and obligations separate from the partners. In a firm every partner is an agent of the rest of the partners, but a member of a company is neither the agent of the company nor of other members. A company, as soon as it is incorporated, say by registration under the Companies Act, becomes a legal entity distinct from its members constituting it (*Salomon* v. *Salomon & Co.*, 1897, A.C. 22). It can sue and be sued in its own name like any natural person. In a partnership, there are rights and obligations as against individual partners, but in the case of a company, the rights and obligations are as against the fictitious entity of the whole of the company and not the members composing it. The creditors of the partnership can call upon individual partners to pay the firm's debt, but the members of a company are not personally liable for the company's debts. In other words, a partner's liability is unlimited while the liability of the members of a company is limited to the extent of the amount remaining unpaid on their shares (*Prasad* v. *Missir*). Partnership firm may dissolve by the death or insolvency of a partner, but a company is not affected by the death or insolvency of a member. A partner cannot transfer his interest so as to substitute the transferee in his place as the partner, without the consent of all the other partners; a member can transfer his share to any one he likes. The maximum number of partners for a banking firm is 10 and for other firms it is 20, while the maximum number of members for a private company is 50 and a public company can have any number of members.

Change in a Firm

The Indian Partnership Act, 1932, contemplates the following changes in a partnership firm:

(1) Changes in the constitution of a firm.

(2) Changes in the nature of a business or undertakings.

(3) Changes in the duration of a firm.

A change in the constitution of a firm takes place when:

(a) a new partner is introduced as a partner in a firm (Section 31)

(b) a partner retires from a firm (Section 32)

(c) a partner is expelled from a firm (Section 33)

(d) a partner is adjudicated as an insolvent (Section 34)

(e) a partner dies (Section 35)

A change in the nature of the business can only be brought about by the consent of all the partners. Thus, a partnership formed for a definite purpose, agreed upon at the time of formation of the partnership, cannot depart from the agreed purpose without the consent of all the partners [Section 12(c)]. Section 17(c)provides for a case whether a partnership firm is formed for a particular undertaking or undertakings, it proceeds to carry on other undertaking or undertakings, in that event the mutual rights and duties of the partners in respect of the other adventures or undertakings remains the same as those in respect of the original adventures of undertakings.

Partnership Property

It is open to the partners to agree among themselves as to what is to be treated as the property of the firm, and what is to be separate property of one or more partners, although employed for the purposes of the firm. In the absence of any such agreement, express or implied, the property of the firm is deemed to include:

(a) all property, rights and interests which have been brought into the common stock for the purposes of the partnership by individual partners, whether at the commencement of the business or subsequently added thereto

(b) those acquired in the course of the business with money belonging to the firm

(c) the goodwill of the business (Section 14)

The property of the firm belongs to the firm and not to the individual partner or partners. The ownership belongs to the firm, and no partner can deal with specific properties as if the properties are his own, nor does the partner possess any assignable interest in such property (*Narayanappa* v. *Bhaskaia Krishnappa*, AIR 1966 SC 1300). What is meant by the share of a partner is his proportion of the partnership assets after they are all realised and converted into money, and all the partnership debts and liabilities have been paid and discharged. If certain partners jointly own immovable property which they use for the purposes of the partnership business, the mere use of such property does not make such property as partnership property. Whether such property is or is not partnership property depends upon the agreement between the partners (*Lachhman Dass* v. *Mrs. Gulab Devi*, AIR 1936 ALL. 270). The ultimate test to determine the property of the firm is the real intention of the partners and the Court can take into consideration the following facts:

(1) The source of the purchase money.

(2) The reason due to which the property was purchased or acquired.

(3) The object for which the property was purchased or acquired.

(4) The mode in which the property was obtained.

(5) The mode in which the property was dealt with.

(6) The use to which the property was put to.

All such facts are matter of evidence and depend on the facts of each case. These facts indicate the intention of the parties but are not conclusive to make a property as partnership property. These facts can be established by entries in the books of account of the firm and of the partners, correspondence, the deed of partnership, etc.

KINDS OF PARTNERS

The following kinds of partners generally exist in a partnership:

(i) Actual, Active or Ostensible Partner

These are the ordinary types of partners who invest money into the business of the firm, actively participate in the functioning and management of the business and share its profits or losses. Section 12(a) lays down that "Subject to contract between the partners, every partner is entitled to take part in the conduct of the business of the firm". Such partner as actively participates in the firm's business, binds himself and other partners by all his acts done in the usual course of partnership business. Such partner must give a public notice of his retirement from the firm in order to absolve (free) himself from liability for the acts of the other partners done after his retirement.

(ii) Sleeping or Dormant Partner

These partners invest money in the firm's business and take their share of profits but do not participate in the functioning and management of the business. But even then their liability is unlimited. The Act specially provides that if an act is binding on the firm, every partner is liable for it.

A sleeping partner can retire from the firm without giving any public notice to this effect. His liability for the acts of the firm ceases soon after retirement. Such partner has no duties to perform but is entitled to have access to books and accounts of the firm and he can have a copy of them.

(iii) Nominal Partner

Some people do not invest or participate in the management of the firm but only give their name to the business or firm. They are nominal partners but are liable to third parties for all the acts of the firm. Unlike a sleeping partner, they are known to the outsiders as partners in the firm, whereas actually they are not. They require to give public notice at the time of being separate from the firm.

(iv) Partner in Profits Only

A partner who is entitled to share in the profits of a partnership firm without being liable to share the losses, is called a partner in profits only. Thus, a person who has sufficient capital but is not prepared to take risk may be admitted to the partnership by the other partners. Inspite of his specific position, he continues to be liable to the third parties for all acts of the firm, just like other partners.

(v) Sub-Partner

Where a partner agrees to share his profits in the firm with a third person, that third person is called a sub-partner. All sub-partner is not the partner in firm. He is partner of a partner. Such a sub-partner has no rights or duties towards the firm and does not carry any liability for the debts of the firm. He can neither participate in partnership business nor check the accounts of such partner and to claim share. Also he cannot bind the firm or other partners by his acts. The only right he has to share the profits in property at the time of winding-up.

(vi) Partner by Estoppel or Holding Out

If the behaviour of a person arouses misunderstanding that he is a partner in a firm (when actually he is not), such a person is estopped from later on denying the liabilities for the acts of the firm. Such person is called partner by estoppel and is liable to all third parties.

Similarly, if a person who is declared to be a partner (when actually he is not) does not deny the fact that he is a partner, he being held out as a partner is responsible for all liability of the business. The law relating to partners by holding out is contained in Section 28 of the Act which lays down thus:

“Any one who by words, spoken or written or by conduct represents himself, or knowingly permits himself to be represented to be a partner in a firm, is liable as a partner in that firm to any one who has on the faith of any such representation given credit to the firm, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit”. The rule as to holding out is based on the doctrine of estoppel as contained in Section 115 of the Indian Evidence Act.

Holding Out means “to represent”. Strangers, who hold themselves out or represent themselves to be partners in a firm, whereby they induce others to give credit to the partnership are called “Partners by Holding Out”. An active partner who fails to give public notice at the time of retirement is also liable as partner by holding out.

In case of “Partnership by Estoppel”, the representation is made by partners about a stranger within his knowledge and hearing and he does not contradict it. He is then held liable as a partner.

Effects of Holding out

The Holding Out partner becomes personally and individually liable for the acts of the firm. But he does not become a partner in the firm and is not entitled to any rights or claim upon the firm. An outsider, who has given credit to the firm thinking him to be a partner, can hold him liable as if he is a partner in that firm. As the liability of the partners is joint and several he can be held liable to pay the entire amount. But under the doctrine of subrogation as well as on the basis of quasi-contract, he can recover the amount so paid from the partners of the firm, if they are solvent.

Exceptions to Holding Out

The doctrine of Holding Out is not applicable in the following cases:

1. It does not apply to cases of torts committed by partners. A person, therefore, cannot be held liable for the torts of another simply because that other person held himself to be his partner.
2. It does not extend to bind the estate of a deceased partner, where after a partner’s death the business of the firm is continued in the old firm name. [Section 28(2)]
3. It also does not apply where the Holding Out partner has been adjudicated insolvent. (Section 45)

Minor Admitted to the Benefits of Partnership

In view of Section 11 of the Indian Contract Act, 1872, and the decision of the Privy Council in *Mohri Bibi* v.

Dharmo Das Ghose, (1903) 30 I.A 114, a minor's agreement is altogether void and not enforceable. An agreement is an essential ingredient in a partnership, it follows that a minor cannot enter into an agreement of partnership as he is incompetent to enter into a contract. On the same principle, a minor cannot be clothed with all the rights and obligations of a full-fledged partner through a guardian. Section 5 states "The relation of partnership arises from a contract..." The minor is incompetent to contract and, therefore, partnership cannot come into existence if the parties to a contract of partnership consist of one major and one minor. The only provision that Section 30 makes is that with the "consent of all the partners for the time being, a minor can be admitted into the benefits of partnership to which a minor is going to be admitted". A partnership firm cannot be formed with a minor as partner. The only fact is that in an existing firm a minor can be admitted only for profits with the consent of all partners.

Rights of Minor

He is entitled to his agreed share and can inspect books of account of the firm [Section 30(2)]. He can bring a suit for account and his share when he intends to sever his connections with the firm, but not otherwise. [Section 30(4)]

A minor who was admitted to the benefits during his minority within six months of his attaining the age of majority or when he comes to know of his being so admitted (whichever date is later), he has to elect whether he wants to become a partner, or sever his connection with the firm. He may give public notice of his election to continue or repudiate, but if he fails to give any public notice within the period stated above, he will be deemed to have elected to become a partner in the firm. [Section 30(5)]

Liabilities of Minor

(i) ***Share in Liability:*** A minor partner's liability is confined only to the extent of his share in the firm. Section 30(3) provides that a minor's share is liable for the acts of the firm. But a minor is not personally liable in any such act. Thus, he is neither personally liable nor is his private estate liable for the acts of the firm.

(ii) ***Personal Liabilities:*** Where a minor on attaining majority, elects to become a partner, he becomes personally liable as other partners to the third parties for all the acts of the firm done since he was admitted to the benefits of partnership.

(iii) ***Election by Minor:*** A minor who was admitted to the benefits during his minority within six months of his attaining the age of majority or when he comes to know of his being so admitted (whichever date is later), he has to elect whether he wants to become a partner, or sever his connection with the firm. He may give public notice of his election to continue or repudiate, but if he fails to give any public notice within the period stated above, he will be deemed to have elected to become a partner in the firm. [Section 30(5)]

If he becomes or elects to become a partner, his position will be as under:

1. His rights and liabilities will be similar to those of a full-fledged partner.
2. He will be personally liable for all the acts of the firm, done since he was first admitted to the benefits of the partnership.
3. His share of profits and property remains the same as was before, unless altered by agreement.

If he elects not to become a partner, then:

1. His rights and liabilities shall continue to be those of a minor upto the date of his giving public notice.
2. His share shall not be liable for any acts of the firm done after the date of the public notice.
3. He is entitled to sue the partners for his share of the property and profits in the firm. [Section 30(8)]

Relation of Partners to one another

The relation of partnership arises through an agreement between the parties and such an agreement normally provides for mutual rights and obligations, or duties of the partners. Where, however, partnership arises by implication, or wherever the articles of partnership are silent, or where they do not exist, the rights and duties of partners are governed by the Act.

Rights of Partners

Unless otherwise agreed by the partners, the following rules apply:

(a) Every partner has a right to take part in the conduct and management of the business. [Section 12(a)]

(b) Every partner whether active or dormant, has a right of free access to all records, books and accounts of the business and also to examine and copy them. [Section 12(d)]

(c) Every partner is entitled to share in the profits equally, unless different proportions are stipulated. [Section 13(b)]

(d) A partner who has contributed more than the share of the capital for the purpose of the business is entitled to an interest at a rate agreed upon, and where no rate is stipulated for, at six per cent per annum. But a partner cannot claim interest on capital, unless there is an agreement to pay it. [Section 13(d)]

(e) A partner is entitled to be indemnified by the firm for all expenses incurred by him in the course of the business, for all payments made by him in respect of partnership debts or liabilities and disbursements made in an emergency for protecting the firm from loss. [Section 13(e)]

(f) Every partner is, as a rule, a joint owner of the partnership property, and have it applied exclusively for the purposes of the partnership. (Section 15)

(g) A partner has power to act in an emergency for protecting the firm from loss. (Section 21)

(h) Every partner is entitled to prevent the introduction of a new partner into the firm without his consent. (Section 31)

(i) Every partner has a right to retire by giving notice where the partnership is at will. [Section 32(1)(c)]

(j) Every partner has a right to continue in the partnership and not to be expelled from it. [Section 33(1)]

(k) An incoming partner will not be liable for any debts or liabilities of the firm before he becomes a partner. [Section 31(2)] (l)

(l) Every outgoing partner has a right to carry on a competitive business under certain conditions. (Section 36)

Duties of Partners

Apart from any duties imposed by the partnership articles, the following statutory duties are implied:

(a) Every partner is bound to carry on the business of the firm to the greatest common advantage. (Section 9)

(b) Every partner must be just and faithful to other partners. (Section 9)

(c) A partner is bound to keep and render true, proper and correct accounts of the partnership. (Section 9)

(d) Utmost good faith between the partners is the rule and one partner must not take advantage of the other. As an agent of other partners, every partner is bound to communicate full information to them. (Section 9)

(e) Every partner must account for any benefits derived from the partnership business without the consent of the other partners, i.e., a partner must not make “secret profits”. [Section 16(a)]

(f) A partner must not compete with the firm, without the consent of the other partners. Any profits made by such unauthorised competition can be claimed by the firm. [Section 16(b)]

(g) Every partner is bound to attend diligently to the business of the firm and in the absence of any agreement to the contrary, he is not entitled to receive any remuneration. [Section 12(b) and 13(a)]

(h) In the absence of an agreement to the contrary, every partner is bound to share losses equally with the others. [Section 13(b)]

(i) Every partner must hold and use the partnership property exclusively for the firm. (Section 15)

(j) Every partner is bound to indemnify the firm for any loss caused by fraud in the conduct of the business. (Section 10)

(k) A partner who is guilty of wilful neglect in the conduct of the business and the firm suffers loss in consequence, is bound to make compensation to the firm and other partners. [Section 13(f)]

(l) No partner can assign or transfer his partnership interest to any other person, so as to make him a partner in the business. (Section 29)

(m) But a partner may assign the profits and share in the partnership assets. But the assignee or transferee will have no right to ask for the accounts or to interfere in the management of the business; he would be entitled only to share the actual profits. On dissolution of the firm, he will be entitled to the share of the assets and also to accounts but only from the date of dissolution. (Section 29)

(n) Every partner is bound to act within the scope of his actual authority. If he exceeds his authority, he shall compensate the other partners for loss unless they ratify his act.

Relation of Partners to Third Parties

Partners as Agents

Every partner is an agent of the firm and of other partners for the purpose of the business of the firm (Section 18). In the case of a partnership each partner is a principal and each one is an agent for the other partners. A partner is both a principal and an agent. Thus, the general law of agency is incorporated into the law of partnership. The law of partnership is often regarded as branch of the law of agency. The acts of every partner who does any act for carrying on in the usual way the business of the kind carried on by the firm bind the firm and his partners unless:

(i) The partner so acting has no authority to act for the firm in that matter; and

(ii) The person with whom he is dealing knows that he has no authority; or

(iii) Does not know or believe him to be a partner.

Authority of a Partner

The authority of a partner means the capacity of a partner to bind the firm by his act. This authority may be express or implied.

(i) Express Authority

Authority is said to be express when it is given by words, spoken or written. The firm is bound by all acts of a partner done within the scope of his express authority even if the acts are not within the scope of the partnership business.

(ii) Implied Authority

The authority which is inferred from the conduct of the parties, nature of business, circumstances, customs and usage are said to be implied authority.

Sections 19 and 22 contain provisions regarding the scope of the implied authority of a partner. The implied authority is subject to the following conditions:

(1) the act done must relate to the "normal business" of the firm;

(2) the act must be done in the usual way;

(3) the act must be done in the name of the firm.

Implied Authority of a Partner

Subject to the limitations mentioned above, every partner binds the firm for the acts done within the scope of implied authority. Following acts are under the implied authority:

(i) To sale firm's goods;

(ii) To Purchase goods for the firm;

(iii) To accept any payment of debts due to the firm; and

(iv) To engage and discharge employees.

In a Trading Firm (one which carries on business of buying and selling goods), a partner has the following additional powers:

(i) To borrow money on the firm's credit and to pledge the firm's goods for that purpose;

(ii) To accept, make and issue negotiable instruments in the firm's name; and

(iii) To employ a solicitor or attorney on behalf of the firm (Bank of Australasia v. Beriliat, (1847) 6 Moor, P.C. 152 at pp. 193-94).

Acts beyond Implied Authority

Section 19(2) states that in the absence of any usage or custom or trade to the contrary, the implied authority of a partner does not empower him to:

(a) submit a dispute relating to the business of the firm to arbitration;

(b) open a bank account on behalf of the firm in his own name;

(c) compromise or relinquish any claim or portion of a claim by the firm;

(d) withdraw a suit or proceeding filed on behalf of the firm;

(e) admit any liability in a suit or proceedings against the firm;

(f) acquire immovable property on behalf of the firm;

(g) transfer immovable property belonging to the firm; and

(h) enter into a partnership on behalf of the firm.

Extent of Partners' Liability

It is, however, open to the partners by means of an express contract to extend or limit the implied authority, but third parties will be bound by such limitations only when they have notice of such curtailment.

All partners are liable jointly and severally for all acts or omissions binding on the firm including liabilities arising from contracts as well as torts (Section 25). This is known as the liability of partners for the acts of the firm. But in order that an act done may be an act of the firm and, therefore, binding on the firm, it is necessary that the partner doing the act on behalf of the firm must have done that act in the name of and on behalf of the firm and not in his personal capacity. And the act must have been done in the ordinary course of the business of the firm. [Sections 19(1) and 22]

Liability of the Firm for Torts

Every partner is liable for the negligence and fraud of the other partners in the course of the management of business. A partner binds the firm if he acts as an agent for it. The firm is similarly liable where a partner commits a tort with the authority of his co-partners. (Section 26)

If a partner acting within the scope of his apparent authority receives the property of a third person and misapplies it, or if the firm in the course of its business receives the property of a third person and, while it is in the firm's custody, a partner misapplies it, in each case the firm is liable to make good the loss. (Section 27)

Liability of an Incoming Partner

As a general rule, an incoming partner is not liable for the debts incurred before he joined the firm as a partner [Section 31(2)]. The incoming partner may, however, assume liability for past debts by novation, i.e., by a tripartite agreement between (i) the creditor of the firm, (ii) the partners existing at the time the debt was incurred, and (iii) the incoming partner.

Liability of an Outgoing or Retiring Partner

An outgoing partner remains liable for the partnership debts contracted while he was a partner. He may, however, be discharged by novation, i.e., by an agreement between himself, the new firm and the creditors. He may also continue to be liable after retirement if he allows himself to be held out as a partner, e.g. by allowing his name to remain the firm name. To protect himself from his liability, he should give express notice of his retirement to the persons who were dealing with the firm before his retirement or give public notice in the manner as laid down in Section 72 of the Act, that is to say, by publishing it in the Official Gazette and in at least one vernacular newspaper where the firm carries on the business. [Section 32(3)]

Death or Insolvency

The estate of a partner who dies, or who becomes insolvent, is not liable for partnership debts contracted after the date of the death or insolvency. It will, however, be liable for debts incurred before death or insolvency. (Sections 34 and 35)

DISSOLUTION

According to Section 39 "The dissolution of partnership between all the partners of a firm" is called the "Dissolution of the Firm". A dissolution does not necessarily follow because the partnership has ceased to do business, for the partnership may continue for the purpose of realising the assets.

The law of Partnership makes a distinction between the "dissolution of partnership" and "dissolution of firm". Where the relation between all the partners come to an end, it is a dissolution of the firm (Section 39). Where there is an extinction of relationship between some of the partners only, it is a dissolution of partnership. So the dissolution of a partnership may or may not include the dissolution of the firm, but the dissolution of the firm necessarily means the dissolution of the partnership as well.

Dissolution of Partnership

The dissolution of partnership takes place (even when there is no dissolution of the firm) in the following circumstances:

(a) By the expiry of the fixed term for which the partnership was formed. [Section 42(a)]

(b) By the completion of the adventure. [Section 42(b)]

(c) By the death of a partner. [Section 42(c)]

(d) By the insolvency of a partner. [Section 42(d)]

(e) By the retirement of a partner. [Section 42(e)]

In all the above cases, the remaining partners may continue the firm in pursuance of an agreement to that effect. If they do not continue then the dissolution of the firm takes place automatically.

Dissolution of the Firm

In the following cases there is necessarily a breaking up or extinction of the relationship between all the partners of the firm, and closing up of the business:

(a) *By mutual agreement:* A firm may be dissolved where all the partners agree that it shall be dissolved. (Section 40)

(b) *By the insolvency of all the partners but one:* If all the partners or except one all the partners become insolvent, the firm must come to an end, as a partnership firm with one partner cannot continue. [Section 41(a)]

(c) *By business becoming illegal:* If the business of the firm becomes illegal because of some subsequent events, such as change of law, it is automatically or compulsorily dissolved by the operation of law. [Section 41(b)]

(d) *By notice of dissolution:* Where the partnership is at will, the firm may be dissolved at any time, by any partner giving notice in writing of his intention to dissolve the firm, to all the other partners. The dissolution will take place from the date mentioned in the notice or, if no such date is mentioned, as from the date of the communication of the notice. (Section 43)

Dissolution of the Firm through Court

Unlike a partnership at will, the partnership for a fixed period cannot be dissolved by a notice. It could only be dissolved by Court in a suit by a partner. Though remedy of dissolution by a suit is available in case of all kinds of partnership, it is of practical importance in case of partnership for a fixed period.

As per Section 44, the Court may order dissolution of the firm in the following circumstances:

(a) *When a partner becomes of unsound mind*: As the insanity of a partner does not automatically dissolve the firm, either the lunatic through his guardian or other partners may file a suit for the dissolution of the firm, in either case the Court may order dissolution which will take effect from the date of the order.

(b) *Permanent incapacity of a partner*: Where a partner has become permanently incapable of performing his duties as a partner, e.g., he becomes blind, paralytic, etc., the Court may, at the instance of any of the other partners, order the dissolution of the firm.

(c) *Misconduct of a partner affecting the business*: Where a partner is guilty of misconduct, which is likely to affect prejudicially the business of the firm, the Court may dissolve the firm at the instance of any of the other partners. Gambling by a partner or conviction of a partner for travelling without ticket would be sufficient ground for dissolution.

(d) *Persistent disregard of partnership agreement by a partner*: Where a partner frequently commits breaches of the partnership agreement and the other partners find it impossible to carry on the business, the Court may order dissolution at the instance of the other partners.

(e) *Transfer of interest or share by a partner*: A partner is not entitled to assign away his interest so as to introduce a new partner into the firm. Where a partner has transferred the whole of his interest to a third person or where his interest has been attached under a decree or sold under a process of law, the other partners may sue for dissolution.

(f) *Business working at a loss*: The Court may dissolve a partnership firm where it is satisfied that the business of the firm cannot be carried on except at a loss.

(g) *Any just and equitable*: As the grounds mentioned are not exhaustive, the Court may dissolve a firm on any other ground if it is satisfied that it would be just and equitable to dissolve the firm. The Court may order dissolution where the sub-stratum of the partnership firm has gone or where there is a complete deadlock and destruction of confidence between the partners [re. Yenidjee Tobacco Co. Ltd. (1916) 2 Ch. 426].

Effect of Dissolution

(i) *Continuing Authority of Partners:* The authority of partners to bind the firm continues so long as is necessary to wind up the business, provided that the firm is in no case bound by the acts of a partner who has been adjudged an insolvent except on the principle of holding out. (Section 47)

Also each partner has an equitable lien over the firm's assets entitling him to have them applied in payment of the firm's debts, and in payment of whatever is due to partner. This lien can be enforced by injunction forbiding unfair distribution. (Section 46)

(ii) *Continuing Liability of Partners:* The partners continue to be liable to outsiders for any act done by any of them which would have been an act of the firm if done before the dissolution, unless a public notice is given of the dissolution.

After dissolution, the rights and obligations of partners continue in all things necessary for the winding up of the business. The partners may complete unfinished transactions. But this authority is only for the winding up of the affairs of the firm and not for new transactions.

Right to Return of Premium

To buy entry into an existing firm, a new partner sometimes has to pay a premium to the existing partners in addition to any investment of capital. On dissolution, he is entitled to demand the return of a proportion of the premium if the partnership was for a fixed term and was dissolved before the expiry of that term, unless dissolution was caused by (i) agreement, or (ii) misconduct of the party seeking return of the premium, or (iii) death of a partner. (Section 51)

Settlement of Accounts on Dissolution

Section 48 of the Act provides that in settling accounts between the partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed:

(a) Losses, including deficiencies of capital shall be paid first out of undistributed profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits

(b) The assets of the firm, including the sums, contributed by the partners to make up losses or deficiencies of capital shall be applied in the following manner and order:

(i) in paying outside creditors;

(ii) in repaying advances made by partners (distinct from investment of capital);

(iii) in repaying capital to partners; and

(iv) the ultimate residue, if any, shall be divided among the partners in the proportions in which profits are divisible.

Where the assets are not sufficient, the partners have to bear the loss in profit sharing ratio. After they have contributed their share of the deficiency they will be paid rateably the amount due to them by way of their capital (The Rule followed in the case of *Garner* v. *Murray*, 1904 73 L.J. Ch. 66).

Loss due to insolvency of partners

In case a partner is insolvent and is not able to contribute towards the deficiency, the principle laid down in the case of Garner vs. Murray will be applicable.

It helds that :

(a) The solvent partners will contribute only their share of deficiency in cash

(b) The available assets should be distributed among the solvent partners in proportion to their capital.

(c) Thus, the deficiency of capital of the insolvent partners will be distributed among the solvent partners in the ratio of their respective capitals.

Goodwill

This is a partnership asset and means the benefit arising from a firm's business connections or reputation. "It is the advantage which is acquired by a business, beyond the mere value of the capital, stock fund and properly employed therein, in consequence of the general public patronage and encouragement". Though an intangible asset, it has value; and unless otherwise agreed in the partnership articles, upon dissolution it must be sold and the proceeds of sale distributed as capital. Where dissolution is caused by death, the estate of the deceased partner is entitled to share in the proceeds of the sale.

If the goodwill is sold and there is no agreement as to its disposal, any partner can carry on the business, provided that by doing so he does not expose former partners to liability. But if by agreement the goodwill is assigned to any person, he can restrain partners as explained in the next para.

Sale of Goodwill: Where goodwill is sold, either to a partner or to an outsider, the value is divisible among the partners in the same manner as they share profits and losses, unless otherwise agreed.

The rights of the buyer and seller of the goodwill are as follows:

(a) Buyer's Rights: On the sale of goodwill the buyer may, unless the terms in the contract of sale provide otherwise:

(i) represent himself in continuing the business,

(ii) maintain his exclusive rights to the use of the firm name, and

(iii) solicit former customers of the business and restrain the seller of the goodwill from doing so.

(b) Seller's Rights: The vendors may enter into competition with the purchaser unless he is prevented by a valid restraint clause in the contract of sale.

Registration of the Firm

Section 56-71 deal with the registration of a firm and consequences of non-registration.

Registration: The registration of a firm may be effected at any time by sending by post or delivering to the Registrar of the area in which any place of business of the firm is situated or proposed to be situated, a statement in the prescribed form and accompanied by the prescribed fee, stating:

(a) the name of the firm;

(b) the place or principal place of business of the firm;

(c) the names of any other places where the firm carries on business;

(d) the date when each partner joined the firm;

(e) the names in full and permanent addresses of the partners; and

(f) the duration of the firm.

The statement shall be signed and verified by all the partners or by their agents specially authorised in this behalf. (Section 58)

The Partnership Act, 1932, does not make registration of a firm compulsory but it introduces certain disabilities, which makes registration necessary at one time or other. An unregistered firm is not an illegal association.

Effects of Non-Registration

The following are the effects of non-registration of a firm:

1. Sub-section (1) of Section 69 places a bar on the right of the partners of a firm to sue each other or the firm for enforcing any right arising from a contract or conferred by the Partnership Act, if the firm is not registered and the person suing is or has not been shown in the Register of Firms as a partner in the firm.
2. Sub-section (2) of Section 69 places a bar on the institution of a suit by or on behalf of a firm against a third-party if the firm is not registered and the persons suing are or have not been shown in the Register of Firms as partners in the firm.
3. There is no bar on the right of third-parties to sue the firm or any partner.

   However, the Act allows the following suits:

   (a) A suit for the dissolution of a firm.

   (b) A suit for rendering of accounts of a dissolved firm.

   (c) A suit for realisation of the property of a dissolved firm.

   (d) A suit or claim of set-off, the value of which does not exceed one hundred rupees,

   (e) A proceeding in execution or other proceeding incidental to or arising from a suit or claim for not exceeding one hundred rupees in value.

   (f) A suit by a firm which has no place of business in the territories to which the Indian Partnership Act extends.

   (g) A suit for the realisation of the property of an insolvent partner.

   (h) A suit by a firm whose places of business are situated in areas which are exempted from the application of Chapter VII of the Indian Partnership Act, 1932.

Section 69 bars the very institution of a suit by an unregistered firm or by its partners. Registration is a condition precedent to the right to institute the suit and, therefore, the condition precedent must first be fulfilled before the institution of the suit. If, therefore, on the date of the institution of a suit, the firm is not registered, the subsequent registration cannot validate the suit. The only option left to the Court is to dismiss the suit (*Prithvi Singh* v. *Hasan Ali*, (1950) Bom. L.R. 862). By virtue of this provision a partner of an unregistered firm cannot institute a suit to compel the other partner or partners to join in the registration of firm. The only remedy of such a partner is to institute a suit for dissolution (*Keshav Lal* v. *Chuni Lal*, AIR 1941 Rangoon 196). A suit by the firm is really a suit by all the partners who were its partners at the time of the accrual of the cause of action and, therefore, all must join in the institution of the suit.

However, an unregistered firm can bring a suit to enforce a right arising otherwise than out of contract e.g., for an injunction against a person for wrongful infringement of trade mark etc.

Specific Performance of Partnership Agreement

The working of a partnership depends upon the personal inclination of the partners, there can be no specific performance of a partnership agreement (Scott v. Raymont, 1868, 7 Fq. 112).

Suit for Libel or Slander

A firm is merely a collection of partners and cannot bring a suit for libel or slander. Libel or slander against a firm imply a libel or slander of its partners. Such partners themselves or any one may file the suit for libel or slander (*P. K. Oswal Hosiery Mills* v. *Tilak Chand*, AIR 1969, Punj. 150).

LESSON ROUND UP

– The Indian Partnership Act, 1932 lays down the important provisions relating to partnership contracts. According to Section 4 "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

– The definition tells us that in order that persons may become partners, it is essential that:

- There must be at least two persons
- There must be a relationship arising out of an agreement between two or more persons to do a business
- The agreement must be to share the profits of a business
- The business must be carried on by all or any of them acting for all

– A partnership may either be for a particular adventure or for a fixed period. It may also be a partnership at will.

– Kinds of Partners

- Actual, Active or Ostensible Partner
- Sleeping or Dormant Partner
- Nominal Partner
- Partner in Profits Only
- Sub-Partner
- Partner by Estoppel or Holding Out

– The minor is incompetent to contract and, therefore, partnership cannot come into existence if the parties to a contract of partnership consist of one major and one minor.

– Every partner is an agent of the firm and of other partners for the purpose of the business of the firm.

- The authority of a partner means the capacity of a partner to bind the firm by his act. This authority may be express or implied.
- All partners are liable jointly and severally for all acts or omissions binding on the firm including liabilities arising from contracts as well as torts.
- The dissolution of partnership between all the partners of a firm" is called the "Dissolution of the Firm". A dissolution does not necessarily follow because the partnership has ceased to do business, for the partnership may continue for the purpose of realising the assets.

GLOSSARY

Ostensible Partner A partner who invests money into the business of the firm, actively participates in the functioning and management of the business and shares its profits or losses.

Dormant Partner A partner who invests money in the firm's business and shares profits but does not participate in the functioning and management of the business.

Nominal Partner A partner who does not invest or participate in the management of the firm but only give their name to the business or firm.

Partner in Profits Only A partner who is entitled to share the profits of a partnership firm without being liable to share the losses.

Sub Partner Where a partner agrees to share his profits in the firm with a third person, that third person is called a sub-partner.

Partner by Estoppel Goodwill If the behaviour of a person arouses misunderstanding that he is a partner in a firm (when actually he is not), such a person is estopped from later on denying the liabilities for the acts of the firm. Such person is called partner by estoppel and is liable to all third parties.

SELF-TEST QUESTIONS

1. Describe the essentials of partnership. What is the true test of partnership?
2. Distinguish between (i) co-ownership and partnership, (ii) Hindu Joint Family firm and partnership, (iii) company and partnership, (iv) dissolution of partnership and dissolution of a firm.
3. What is the position of a minor in a partnership?
4. Discuss the liability of partners inter se.
5. Whether registration of a firm is compulsory? Discuss the effects of non-registration.
6. Briefly discuss the provisions relating to the dissolution of partnership or firm and what are its effects?
7. Write short notes on:
   (i) Specific performance of partnership agreement.
   (ii) Whether a firm can bring a suit for libel or slander.
8. "Sharing of profits is a *prima facie* evidence of partnership but not a conclusive evidence". – Discuss

Suggested Readings

(1) A manual of Mercantile Law – *M.C. Shukla*

(2) The Indian Partnership Act, 1932 – *Bare Act*

(3) Elements of Mercantile Law – *N. D. Kapoor*

(4) Law of Partnership – *Avtar Singh.*

Lesson 10
Indian Contract Act, 1872

LESSON OUTLINE

- Meaning and Nature of Contract
- Agreement
- Obligation
- Rights and Obligations
- Essential Elements of a Valid Contract
- Flaws in Contract
  - Void Agreement
  - Voidable Contract
  - Illegal Agreement
- Discharge or Termination of Contracts
- Contract of Indemnity and Guarantee
- Contract of Bailment and Pledge
- Law of Agency
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

Every man in his day to day life from dawn to dusk makes a variety of contracts. Man's contract making activities increases with the increasing trade, commerce and industry. In a way, living in a modern society `would be impossible if the law did not recognize this contract making power of a person. This prompted Roscoe Pound to make his celebrated observation: "Wealth, in a commercial age, is made up largely of promises". In this sense, India is also a 'promissory' society.

The conferment and protection by the law of this contract making power of persons gives them a considerable leeway to strike best bargain for the contract making persons. In a way, they are permitted to regulate and define their relations in a best possible manner they choose. However, the contours of contractual relations in a feudal, colonial and capitalist society of pre-independence India cannot necessarily be the same in an independent and developing Indian society. Whatever way be the nature of a given society, the contractual relations, as are obtained in that society, are governed by certain principles which are more or less of a general and basic nature. In India these general principles are statutised by Indian Contract Act, 1872.

The Law of Contract is intended to ensure that what a man has been led to input shall come to pass, that what has been promised to him shall be performed.

Sir William Anson

INTRODUCTION OF INDIAN CONTRACT ACT, 1872

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

The law relating to contracts in India is contained in Indian Contract Act, 1872. It came into force from September, 1872. It is applicable to All the States of India except the State of Jammu & Kashmir[1]. It determines the circumstances in which promise made by the parties to a contract shall be legally binding on them. All of us enter into a number of contracts everyday knowingly or unknowingly. Each contract creates some right and duties upon the contracting parties. Indian Contract deals with the enforcement of these rights and duties upon the parties in India.

Provisions	Section
General Principles of Law of Contract	1 to 75
Contract relating to Sale of Goods	76 to 129
Special kinds of Contracts (includes indemnity, guarantee, bailment &pledge)	125 to 238
Contracts relating to Partnership	239 to 266

Indian Contract Act embodied the simple and elementary rules relating to Sale of goods and partnership. The developments of modern business world found the provisions contained in the Indian Contract Act inadequate to deal with the new regulations or give effect to the new principles. Subsequently the provisions relating to the sale of goods and partnership contained in the Indian Contract Act were repealed respectively in the year 1930 and 1932 and new enactments namely Sale of Goods and Movables Act 1930 and Indian Partnership act 1932 were re-enacted.

At present the Indian Contract Act includes:

Provisions	Section
General Principles of Law of Contract	1 to 75
Special kinds of Contracts (includes indemnity, guarantee, bailment & pledge)	125 to 238

IMPORTANT FACTS ABOUT INDIAN CONTRACT ACT, 1872

Rights available to parties under Indian Contract Act

(a) Rights in Rem (jus in rem)

A right in rem is available against the world at large. This right protects interest against the world and there is a duty upon every person of the world not to interfere with other's rights. It is available against an open or indefinite class of persons. The freedoms given in article 19 of the Indian constitution with its restrictions are the rights in rem.

Example: X has a house. The people of the world have a duty not to interfere with his ownership. Nobody has right to disturb his possession

I have money in my pocket. I can use my money as like. The world at large has no right to interfere with my possession.

1. The State of Jammu & Kashmir enjoys a special status under Article - 370 of Indian Constitution.

(b) Rights in Personam (jus in personam)

A right in personam is available only against a particular person or party. This right protects an interest solely against determinate individuals and duty imposed upon determinate individuals. Indian Contract Act, 1872 provides right in personam to the parties who enters in to the contract thus, the parties to the contract can exercise their contractual rights against each other only.

Example: X let his house to Z-tenant. X has a right to receive rent from his tenant. This right to receive rent from his tenant, is a right in personam. The rest of the world is not concerned with this right.

Assumptions

(a) There shall be freedom to the parties to the contract to determine their rights and obligations under contract and law shall enforce only what the parties have agreed to be bound subject to certain limited principles.

(b) Rights and obligations created by parties shall be performed and their non performance shall give rise to legal consequences .

Law of contract is not the whole law of agreements

The law of contract is concerned only with only those agreements which contains all essentials under section 10 and where the parties have intension to create legal obligation thus the law of contract does not covers all agreements such as social, political, religious and other agreements without legal intensions.

The law of contract is not the whole law of obligation

The Indian contract act shall not lay down absolute rights and obligations of the contracting parties. It enforce only those obligations which are agreed by the parties under a contract i.e. contractual obligation. Thus it is not concerned with obligations arises by the statutes, torts or judgment of courts.

It has no retrospective effect

The law of the contract enacted as on 1st September, 1872, and applies only on those contracts which are formed as on 1st September, 1872 or after it. It does not have retrospective effect therefore, does not enforce those contract which are formed prior to 1st September, 1872.

DEFINITION OF CONTRACT

Salmon defines contact as “An agreement creating and defining obligation between agreement as the parties “

Sir Federick Pollock defines it as “Every agreement and promise enforceable at law is a contract.”

Section 2(h) of the Act defines the term contract as “an agreement enforceable by law is a contract”. The definition resolves that a contract is fundamentally an agreement that binds the parties legally, thus,

Contract = Agreement + Enforceability

RELATED TERMINOLOGY

Agreement

An agreement occurs when two minds meet upon a common purpose, i.e. they mean the same thing in the same sense at the same time. The meeting of the minds is called *consensus-ad-idem*, i.e., consent to the matter.

Section 2(e) defines the term 'agreement' as "Every promise and every set of promise, forming the consideration for each other"

In other words, an agreement consist of an offer by one party and its acceptance by the other party whom the offer was made

Thus, Agreement = Offer + Acceptance

Offer

Section 2 (a) defines proposal (offer) as "When one person signifies to another his willingness to do or to abstain from doing something with a view to obtain the assent of that other to such act or abstinence, he is said to make a proposal."

Promise

Section 2 (b) defines "a proposal (offer) when accepted becomes a promise." Thus an accepted offer is a promise.

Acceptance

Section 2(b) "when the person to whom the offer is made signifies his assent there to, the proposal is said to be accepted."

Enforceability

Enforceability means creation of some legal obligations! An agreement is said to be enforceable only after complying all the requirements under section 10 of Indian contract act and only those agreements called contracts which have enforceability.

However, there may be certain agreements which do not converts into contracts as there may be absence of one or more essentials as prescribed under section 10. Such agreement neither creates any contractual rights nor obligations on the parties.

It is said that all agreements are not contract but on the other hand all contracts are agreement because every contract contains agreement as well as all essentials as required by the Indian contract Act. Agreement is the basis for every contract as Section 2(h) revels that "a contract is an agreement enforceable by law." Therefore every contract is an agreement two but every agreement need not be contract necessarily, as there may be lack of any essential and due to absence of essential it remains an agreement.

For example agreement between the family members, are remains agreement as there is no legal intention., similarly agreement by incompetent person cannot be converted into contract because the agreement by incompetent person are void under The Indian Contract Act.

DISTINGUISH BETWEEN AGREEMENT AND CONTRACT

An agreement differs from a contract in the following respects:

Basis	Agreement	Contract
1. Defination	Every promise and set of consideration for each other is an agreement	An agreement enforceable by Law is a contract.
2. Formation	Offer and its acceptance Constitute an agreement.	Agreement and its enforceability constitute a contract.

3. Legal obligation	An agreement may or may not create a legal obligation.	A contract necessarily create a legal obligation.
4. One in other	Every agreement need not necessarily be a contract.	All contracts are necessarily agreements.
5. Scope	Scope of agreement is wider as it covers all types of agreement as wall as contract.	Scope of contract is narrow in comparison to agreement as it covers only those agreement which are enforceable.

ESSENTIAL ELEMENTS OF A VALID CONTRACT [Section 10]

According to Section 10, "All agreements are contracts if they are made by free consent of parties, competent to contract, for a lawful consideration and with a lawful object and are not hereby expressly declared to be void". The analysis of section 10 and section 2(b) reveals that an agreement must have certain essential elements to constitute contract. The essential elements of a valid contract are:

1. **Two Parties**: To constitute a contract there must be at least two parties, i.e. one party making an offer (offerer / proposar) and the other party accepting the offer (offeree / proposee). The terms of the offer must be definite.
2. **Agreement:** A contract is initially an agreement when person whom the offer has given signifies his acceptance on it there arises an agreement which is the foundation of a contract.
3. **Consent:** There must be consensus-ad-idem (meeting of minds) to constitute a valid contract unity of minds i.e. consensus-ad-idem means that the parties must agree to the same thing in the same sense and at the same time. An agreement without consent is void.
4. **Intention to create legal relationship:** There must be an intention by both parties to create legal relationship and to legally bind themselves as a result of such agreement. Thus, agreements of social or household nature are not contracts, as the usual presumption is that the parties do not intend to create legal relationship unless otherwise agreed upon. However, in case of commercial transaction the usual presumption is that parties intend to create legal relationship.
5. **Contractual Capacity:** The parties to the agreement must be capable of entering into a valid contract. According to Section 11, every person is competent to contract if he or she,

   (a) is of the age of majority;

   (b) is of sound mind; and

   (c) is not disqualified from contracting by any law to which he/she is subject.
6. **Consideration:** An agreement by incompetent person is void. A valid contract must be supported by consideration. Consideration means "something in return" (quid pro quo). It can be cash, kind, an act or abstinence. It can be past, present or future. However, consideration must be real and lawful. An agreement without consideration is void however, it need not to be adequate, if parties are agreed in it.
7. **Free consent:** The parties are said to be on consent when they are agreed upon the same thing in the same sense, in addition to it, to constitute a valid contract there must be free and genuine consent of the parties to the contract, consent is said to be free if it must not be obtained by misrepresentation, fraud, coercion, undue influence or mistake. It the consent is not free, the contract becomes voidable.
8. **Lawful object and consideration:** The object as well as consideration of the Contract must not be unlawful. According to Section 23, the consideration or object of an agreement is un lawful, if

   - It is forbidden by law; or

- it Is of such nature that, if permitted it would defeat the provisions of any law or
- It is fraudulent; or
- it Involves or implies, injury to the person or property of another; or
- The court regards it as immoral, or

8. **Agreement not declared void:** Under the provisions of Indian Contract Act, 1872 certain agreement are expressly declared as void. Agreements which have been expressly declared void are not enforceable at law; hence does not constitute a valid contract. For example agreement of wager, agreement in restraint of trade and marriage.
9. **Certainty of meaning:** The terms of agreement must be certain and not vague. It must be either certain or be certained at the time of execution. If it is not possible to ascertain the meaning of the agreement, it is not enforceable at law.
10. **Possibility to Perform:** The promises made under a valid contract must be executable. An agreement to do some impossible act is void from the beginning and never converted into contract.
11. **Legal formalities:** Although Indian contract Act does not provide any formality to enter into contract therefore a contract may be express (oral or written) or even implied (by conduct). However, where the law requires for a particular contract, it must comply with all the legal formalities such as in writing, registration and attestation.
    (a) For example under the provisions of Immovable Properties Act, a contract of immovable must be written, registered and duly stamped and unless not enforceable by law.

CLASSIFICATION OF CONTRACTS/AGREEMENTS

CLASSIFICATION OF CONTRACTS

On the Basis of Enforceability

I. Contract
II. Void agreement
III. Contract
IV. Void contract
V. Un enforceable Contract
VI. Illegal Agreement

On the Basis of Formation

I. Express contract
II. Tacit contract
III. Implied/Quasi Contracts

On the Basis of Performance

I. Executed contract
II. Executory contract

(a) Unilateral contract
(b) Bilateral contract

I. On the basis of enforceability

Contract: [Section 2 (b)] “A contract is an agreement enforceable by law” an agreement becomes contract if it has all the essential elements of a contract. A valid contract can be enforced by law.

Example: X offers Y to supply 10 bags of rice for ₹ 50,000/- Y agreed for it, it is a contract.

Void agreement: Section 2 (g) "An agreement not enforceable by law is said to be void." Such agreement does not confer any right to any of the parties to it. An agreement becomes void due to absence of one or more essentials under section 10. The agreement, in such a case, is void-ab-initio (void from the very beginning) and can never converts contract. Such an agreement does not result in a contract at all.

Example X offers Y a minor to deliver 100 bags of rice. Y agrees but further not supplied the rice. Here X cannot sue Y as Y is minor.

Voidable contract [Section 2(1)]: "An agreement which is enforceable by law at the option of one or

more of the parties thereto, but not at the option of other or others, is a voidable contract". It is a contract where in, the law confers right on the aggrieved party either to reject the contract or to accept it. However, the contract continues to be valid and enforceable unless it is repudiated by the aggrieved party.

Example: A Threatens B to murder if he does not sell his land for ₹ 100000/- B agreed for it due to threat. It is a voidable contract which can be rejected by B.

1. **Void contract [Section 2(j)]:** "A void contract is a contract which ceases to be enforceable by law". A contract which was valid at the time of formation and binding on the parties however, subsequently become void, due to impossibility to perform is said to be void contract. Example X a famous singer agrees to sing an album for a musical company. Unfortunately suffered from throat cancer and not allowed to sing by doctor. Here the contract becomes void contract.

2. **Unenforceable contract:** Where a contract is good in substance but becomes unenforceable due to some technical defect and cannot be enforced by law is called unenforceable contract. These contracts becomes enforceable when these technical defects (legal formalities) are completed.

   Example A draw a promissory note without stamp it is not enforceable but further after one week a come to know about the mistake and stamped it become enforceable.

3. **Illegal agreement:** When the object and consideration of an agreement is unlawful it is said to be illegal agreement, such an agreement is void. The object and consideration is said to be unlawful if (a) it is forbidden by law; or (b) is of such nature that, if permitted, would defeat the provisions of any law or (c) is fraudulent; or (d) involves or implies injury to a person or property of another, or (e) court regards it as immoral (f) opposed to public policy. These agreements are punishable by law and are void-ab-initio. Example X agrees to paid ₹ 1,00,000/- to Y to murdered Z it is an illegal agreement as it is injurious to Z and forbidden under I.P.C.

   "All illegal agreements are void because an illegal agreement is not enforceable by law but all void agreements are not illegal," as it is not necessary that object and consideration of every agreement is unlawful.

II. On the basis of formation

1. **Express contract:** Where the terms of the contract are expressly agreed upon in words (written or spoken) at the time of formation, the contract is said to be express contract.

2. **Implied contract:** An implied contract is one which is inferred from the acts or conduct of the parties or from the circumstances of the cases. Where a proposal and acceptance is made otherwise than in words, it is said to be implied contract.

3. **Quasi contracts:** A quasi contract is created by law on the basis of principal of equity. There, is no intention of parties to enter into a contract. It is legal obligation which is imposed on a party and is required to perform it. A quasi contract is based on the principle on equity which states that a person shall not be allowed to enrich himself at the cost of another. A quasi contract is a contract imposed by law.

III. On the basis of execution

1. **Executed contract:** when both of the parties to contract have preformed their contractual obligation and nothing remains to be performed it is said to be executory. It is a contract in which both the parties have performed their respective obligation.
2. **Executory contract:** An executory contract is one where one or both the parties to the contract have to perform their obligations in future. Thus, a contract which is partially performed or wholly unperformed is termed as executory contract.

It is of two types:

(a) **Unilateral contract:** A unilateral contract is one in which only one party has to perform his obligation after formation of the contract and the other party have fulfilled his obligation at the time of the contract or before the contract comes into existence.

(b) **Bilateral contract:** A bilateral contract is one in which the obligation of both the parties to the contract is outstanding. In other words when both of parties have still to perform their obligation it is known as bilateral contract. Bilateral contracts are also known as contracts with executory consideration.

DISTINGUISH BETWEEN CONTRACT AND VOID AGREEMENT

Basis	Contract	Void Agreement
1. Definition	An agreement enforceable by law is a contract.	An agreement not enforceable by law is void agreement.
2. Legal Existence	It exist in the eyes of law.	It does not exist in the eyes of law.
3. Essentials	It consists all essentials of valid contract.	It does not consists all essentials of valid contract.
4. Enforceable	It is enforceable by law.	It is not enforceable by law.
5. Damages	Damages can be claimed in case Of non performance.	No damages for non performance.

DISTINGUISH BETWEEN VOID AGREEMENT AND VOID CONTRACT

Basis	Void Agreement	Void Contract
1. Definition	An agreement not enforceable By law is said to be void. [Sect.: (g)]	A contract which ceases to be Enforceable by law becomes void When it ceases to be enforceable [Sec.2 (j)l.
2. Void From beginning	It is void from very beginning.	It is valid in the beginning, it Becomes void subsequently due to or change in circumstances.
3. Restitution	Generally no restitution is gran the by court may on Equitable grounds grant restitution in case of fraud or mis-Representation by minors.	Restitution may be granted When the contract is discover to Be void.
4. Causes	An agreement becomes void Due to absence of one or more Essentials.	It becomes void due to impossibility; To perform.

DISTINGUISH BETWEEN VOID CONTRACT AND VOIDABLE CONTRACT

Basis of distinction	Void contract	Voidable contract
1. Definition	A contract which ceases to be Enforceable by law become void When it ceases to be enforceable	A contract which is enforceable By law at the option of the aggrieved party is a voidable contract.
2. Period of validity	It remains valid till it does not Cease to enforceable.	It remains valid till aggrieved party Avoid it.
3. Option to the party	There is no option with the party To make it enforceable or not	Its validity depends upon the will The aggrieved party. Aggrieved pass has to treat it either valid or void
4. Causes	Contracts become void because Becomes impossible to perform Due to change in circumstances Or in the law of the land.	Contract is voidable when the Consent of the party is not free, Sometimes, it may be voidable under the provisions of the Sections 39, 53 and 55

DISTINGUISH BETWEEN VOID AGREEMENT AND ILLEGAL AGREEMENT

Basis	Void Agreement	Illegal Agreement
1. Definition	An agreement not enforceable by law is void	An agreement which is expressly or impliedly prohibited by law. is illegal.
2. Effect on collateral agreement	An agreement collateral to the Void agreement is not Necessarily void.	An agreement which is collateral **i** agreement is always void.
3. Scope	The scope is wider than that of The illegal agreements. Because every illegal agreement is void also.	Every void agreement is not illegal thus. Its scope is narrow.
4. Restitution	The court may grant restitution On the basis of equity	Restitution of money is not granted in Case of an illegal agreement.
5. Punishment	There is no punishment for void Agreement.	The parties to an illegal agreement are Punishable as per the law of country.

DISTINGUISH BETWEEN EXECUTED CONTRACT AND EXECUTORY CONTRACT

Basis	Executed contract	Executory contract
1. Performance	It such contract performance Of both parties are fulfilled.	It performance of both or At least one party remains.
2. Obligations	There remains no contractual Obligations as parties have Fulfilled their promises.	There remains legal obligations For the parties.
3. Discharge	The parties are discharge From contract.	The parties are not discharged and can be sued.

MEANING AND NATURE OF CONTRACT

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

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

The law relating to contract is governed by the Indian Contract Act, 1872. The Act came into force on the first day of September, 1872. The Act is divisible into two parts. The first part (Section 1-75) deals with the general principles of the law of contract, and therefore applies to all contracts irrespective of their nature. The second part (Sections 124-238) deals with certain special kinds of contracts, namely contracts of Indemnity and Guarantee, Bailment, Pledge, and Agency.

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

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

– Salmond

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

– Anson

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

– Sir Fredrick Pollock

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

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

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

Agreement

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

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

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

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

Obligation

An obligation is the legal duty to do or abstain from doing what one has promised to do or abstain from doing. A contractual obligation arises from a bargain between the parties to the agreement who are called the promisor and the promisee and they requires to perform these promises legally. In broad sense, therefore, a contract is an exchange of promises by two or more persons, resulting in an obligation to do or abstain from doing a particular act, where such obligation is recognised and enforced by law.

Rights and Obligations

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

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

B has a corresponding right to receive the car.

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

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

All agreements are not contracts

An agreement to become a contract must give rise to legal obligation. If an agreement is incapable to be enforce by law, it remains only agreement and not contract, such as:

(a) Social Agreements

(b) Agreements without legal intention

(c) Agreements without consideration, etc., are agreement but not contract. However all contract are agreement. Further all legal obligations are not contract. Only those obligations which have their source in the contract are enforceable under the provisions of Indian Contract Act.

Three consequences follow from the above discussion :

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

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

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

ESSENTIAL ELEMENTS OF A VALID CONTRACT

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

The essential elements of a valid contract are:

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

– An intention to create legal relations or an intent to have legal consequences.

– The agreement is supported by a lawful consideration.

– The parties to the contract are legally capable of contracting.

– Genuine and Free consent between the parties.

– The object and consideration of the contract must be lawful and is not opposed to public policy.

– The terms of the contract are certain, not vague

– The agreement is capable of being performed i.e., it is not impossible of being performed.

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

(a) Offer or Proposal and Acceptance

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

What is an Offer or a Proposal?

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

Rules Governing Offers

A valid offer must comply with the following rules:

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

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

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

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

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

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

An Offer must be Distinguished from

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

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

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

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

Lapse of Offer

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

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

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

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

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

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

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

Revocation of Offer by the Offeror

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

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

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

Acceptance

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

Rules Governing Acceptance

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

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

(c) Acceptance must be unqualified and absolute and must correspond with all the terms of the offer.

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

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

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

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

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

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

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

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

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

Standing Offers

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

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

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

Tickets

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

Contracts by Post

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

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

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

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

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

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

Contracts over the Telephone

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

(b) Intention to Create Legal Relations

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

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

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

(c) Consideration

Need for Consideration

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

Definition of Consideration

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

Consideration is identified as "quid pro quo", i.e. "something in return". This something need not to be in terms of money, as stated in the case of *Currie* v. *Misa* it is "some right, interest, profit or benefit accruing to one party or some for bearance, detriment, loss or responsibility, given suffered or undertaken by the other".

However it must have value in the eyes of law and must not be vague or illusory.

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

The fundamental principle that consideration is essential in every contract, is laid down by both the definitions but there are some important points of difference in respect of the nature and extent of consideration and parties to it under the two systems of law:

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

(b) Consideration may move from the promise or any other person: Section 2(d) of Indian contract Act, 1872 provides that consideration may be furnished by either promise or by any other person. A valid contract must be supported by consideration subject to certain exceptions but it does not matter at all that who has furnished it. Therefore, if in a contract consideration is move from some other person than the promise contract remains valid if it is at the desire of promisor.

In such constructive consideration promise is known as stranger to consideration promise is known as stranger to consideration is however can sue for the enforcement of contract as he is a party to the contract.

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

In English law, consideration must move from the promisee, so that a stranger to the consideration cannot sue on the contract. A person seeking to enforce a simple contract must prove in court that he himself has given the consideration in return for the promise he is seeking to enforce.

Privity of Contract

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

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

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

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

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

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

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

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

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

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

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

Kinds of Consideration

Consideration may be:

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

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

(c) **Past** which means a past act or forbearance, that is to say, an act constituting consideration which took place and is complete (wholly executed) before the promise is made.

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

Rules Governing Consideration

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

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

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

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

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

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

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

When Consideration not Necessary

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

1. If it is expressed in writing and registered and is made out of natural love and affection between parties standing in a near relation to each other; or
2. If it is made to compensate a person who has already done something voluntarily for the promisor, or done something which the promisor was legally compellable to do; or
3. If it is a promise in writing and signed by the person to be charged therewith, or by his agent, to pay a debt barred by the law of limitation.
4. Besides, according to Section 185 of the Indian Contract Act, consideration is not required to create an agency.
5. In the case of gift actually made, no consideration is necessary. There need not be nearness of relation and even if it is, there need not be any natural love and affection between them.

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

Illustrations

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

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

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

Whether Gratuitous Promise can be Enforced

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

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

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

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

Terms Must be Certain

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

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

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

Resume

Thus, a contract is always based upon:

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

(ii) An intent to create legal obligations; and

(iii) Consideration.

FLAWS IN CONTRACT

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

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

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

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

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

Classifcation of Contract/Agreement

(a) Void Agreement

A void agreement is one which is destitute of all legal effects. It cannot be enforced and confers no rights on either party. It is 'void an initio' i.e. not exist in the eyes of law.

Section 2(g) of Indian Contract Act, 1872, defines, "an agreement not enforceable by law is void agreement".

In such agreement there are lack of one or more essentials of a contract such as no legal intention or incompetent parties. Therefore, it remains agreement and cannot be enforce by the parties. For example an agreement without consideration is void.

(b) Void Contract

Section 2(j) of Indian Contract Act, 1872, states, "A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable."

The expression provides a circumstance where a contract can not be claimed to enforce as it is impossible to perform it due to change in situation.

For example throat cancer a singer refused to sing for the musical concert for which he was agreed before six month without knowing his disease. The only remedy is whatever is advanced can be restroted.

(c) Voidable Contract

Section 2(j) defines, "A contract which is enforceable by law at the option of one or more parties but not at the option of the other or others is a voidable contract".

Usually, a contract becomes voidable when the consent of the parties are induced by coercion, undue influence, misrepresentation or fraud. Therefore, it can be rejected by the aggrieved party (the party whose consent was so caused).

However the option must be exercise

(i) within a reasonable time, and

(ii) before the third party acquires the rights until it is avoided it remains valid and enforceable.

(d) Illegal Agreement

An agreement with an unlawful object and consideration is known as illegal agreement.

The object and consideration is said to be unlawful if –

(i) it is forbidden by any law time being in force

(ii) it defeats the provisions of any law

(iii) it is fraudulent

(iv) it is injurious to a person or property

(v) it is immoral

(vi) it is opposed to public policy.

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

(e) Quasi/Implied Contract

"Certain relations resembling those created by contract" are known as quasi contract. Sometimes, obligations are imposed on the parties by law on the basis of principle of equity which states" no one can enrich himself on the cost of other", for example it is the duty of the finder of goods to keep the goods safety and to return it to owner and if due to negligence goods destroyed to indemnify the owner such an obligation is a quasi contract.

(f) Express Contract

A contract where the proposal acceptance and conditions are made in words either written or oral is an express contract.

(g) Tacit Contract

A contract in which offer and acceptance are expressed other than words i.e. conduct of the parties, circumstances is a tacit contract.

For example to withdraw money from an ATM machine is a tacit contract.

(i) Contractual Capacity

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

The general rule is that all natural persons have full capacity to make binding contracts except.

(i) minors,

(ii) lunatics, and

(iii) persons disqualified from contracting by any law to which they are subject.

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

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

Agreement with Minor

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

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

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

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

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

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

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

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

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

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

(d) A minors estate is liable to pay a reasonable price for necessaries supplied to him or to anyone whom the minor is bound to support (Section 68 of the Act). However minor is not liable personally, such contracts are considered as quasi contract.

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

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

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

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

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

(h) An agreement by a parent or guardian entered into on behalf of the minor is binding on him provided it is for his benefit or is for legal necessity. For, the guardian of a minor, may enter into contract for marriage on behalf of the minor, and such a contract would be good in law and an action for its breach would lie, if the contract is for the benefit of the minor (*Rose Fernandez* v. *Joseph Gonsalves*, 48 Bom. L. R. 673) e.g., if the parties are of the community among whom it is customary for parents to contract marriage for their children. (i) The contract of apprenticeship is also binding. The Act, inter alia, provides that the minor must not be less than fourteen years of age and the contract must be entered into by minor's guardian.

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

Agreement by person of unsound mind (Section 2)

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

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

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

Agreement by persons of unsound mind are void. But for necessaries supplied to a lunatic or to any member of his family, the lunatics estate, if any, will be liable. There is no personal liability incurred by the lunatic.

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

(a) Persons Disqualified from Entering into Contract

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

(b) Alien Enemies

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

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

(c) Foreign Sovereigns and Ambassadors

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

(d) Professional Persons

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

(e) Corporations

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

The Indian Contract Act does not speak about the capacity of a corporation to enter into a contract. But if properly incorporated, it has a right to enter into a contract. It can sue and can be sued in its own name. There are some contracts into which a corporation cannot enter without its seal, and others not at all. A company, for instance, cannot contract to marry. Further, its capacity and powers to contract are limited by its charter or memorandum of association. Any contract beyond such power in ultra vires and void.

(f) Married Women

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

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

Free in Consent

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

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

(a) Coercion

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

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

(b) Undue Influence

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

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

Sub-section (2) of Section 16 provides that a person is deemed to be in a position to dominate the will of another –

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

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

Illustration

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

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

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

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

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

(ii) the consideration was adequate, and

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

Transaction with parda-nishin women

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

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

(c) Wilful Misrepresentation or Fraud *(Section 17)*

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

(i) a false representation or assertion;

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

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

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

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

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

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

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

Contracts Uberrimae Fidei

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

Contracts uberrimae fidei are:

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

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

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

(d) *Contracts of family arrangements:* When the members of a family make agreements or arrangements for the settlement of family property, each member of the family must make full disclosure of every material fact within his knowledge.

(d) Misrepresentation *(Section 18)*

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

Innocent Misrepresentation

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

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

(i) there was a representation or assertion,

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

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

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

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

Damages for Innocent Misrepresentation

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

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

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

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

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

Difference between Fraud and Innocent Misrepresentation

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

(e) Mistake (Sections 20 and 21)

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

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

Effect of Mistake

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

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

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

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

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

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

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

Mistake of Law and Mistake of Fact

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

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

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

Mutual or Unilateral Mistake

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

Mutual or Common Mistake as to Subject-matter

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

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

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

(b) *Mistake as to identity of the subject matter:* Where the parties are not in agreement to the identity of the subject matter, i.e., one means one thing and the other means another thing, the contract is void; there is no consensus ad idem.

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

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

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

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

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

Unilateral Mistake as to Nature of the Contract

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

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

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

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

Unilateral Mistake as to the Identity of the Person Contracted With

It is a rule of law that if a person intends to contract with A, B cannot give himself any right under it. Hence, when a contract is made in which personalities of the contracting parties are or may be of importance, no other person can interpose and adopt the contract. For example, where M intends to contract only with A but enters into contract with B believing him to be A, the contract is vitiated by mistake as there is no consensus ad idem.

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

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

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

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

Legal Object and consideration

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

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

(i) forbidden by law; or

(ii) it is of such nature that if permitted it would defeat the provisions of law; or

(iii) is fraudulent; or

(iv) involves or implies injury to the person or property of another; or

(v) the Court regards it an immoral or opposed to public policy.

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

Illustration

(i) X, Y and Z enter into an agreement for the division among them of gains acquired by them by fraud. The agreement is void as its object is unlawful.

(ii) X promises to obtain for Y an employment in the Government service and Y promises to pay ₹ 1,500 to X. The agreement is void, as the consideration for it is unlawful.

(iii) X promises to Y to drop a prosecution which he has instituted against Y for robbery, and Y promises to restore the value of the things taken. The agreement is void as its object is unlawful.

(iv) A who is B’s mukhtr promises to exercise his influence, as such, with B in favour of C and C promises to pay ₹ 1,000 to A. The agreement is void because it is immoral.

(v) A agrees to let her daughter to hire to B for concubinage. The agreement is void because it is immoral though, the letting may not be punishable under the India Penal Code.

(vi) An agreement by the proprietors of a newspaper to indemnify the printers against claims arising from libels printed in the newspaper is void as it implies or involves injury to the person of another.

Void and Illegal Agreements

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

Consequence of Illegal Agreements

(i) an illegal agreement is entirely void;

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

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

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

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

Exception to General Rule of no Recovery of Money or Property

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

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

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

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

Immoral Agreements

An agreement is illegal if its object is immoral or where its consideration is an act of sexual immorality, e.g., an agreement for future illicit co-habitation, the agreement is illegal and so unenforceable. Similarly, where the purpose of the agreement is the furtherance of sexual immorality and both the parties know this, it is illegal. Where A let a taxi on hire to B, a prostitute, knowing that it was to be used for immoral purposes, it was held that A could not recover the hire charges. (*Pearce* v. *Brookes* (1866) L.R. 1 Exch 213).

Agreements Void as being Opposed to Public Policy

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

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

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

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

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

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

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

Agreements in Restraint of Trade Void

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

This Section is not happily worded and has been criticised by many authors. It appears from the wording that every kind of restraint, whether total or partial falls within the prohibition of this Section. In English law the Courts have held that if a restraint is reasonable, it will be valid. Leading case on his point is *Nordenfelt* v. *Maxim Nordenfelt Guns Co.*, (1894) A.C. 535. N was an inventor and a manufacturer of guns and ammunition. He sold his world-wide business to M and promised not to manufacture guns anywhere in the world for 25 years. The House of Lords held that the restraint was reasonable as it was no more than is necessary for the protection of the company, the contract was binding. Whether a restraint is reasonable or not depends upon the facts of each case.

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

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

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

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

When Contracts in Restraint of Trade Valid

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

(a) **Sale of goodwill:** Where the seller of the goodwill of a business undertakes not to compete with the purchaser of the goodwill, the contract is enforceable provided the restraint appears to be reasonable as to territorial limits and the length of time.

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

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

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

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

Wagering Agreements

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

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

Wagering Agreements Void

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

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

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

In a wagering agreement the essence is that the gain of one party is resulted into loss to the other on the happening of an uncertain event and in such event neither of them has bare legitimate interest.

Void Agreements

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

(a) Agreement by or with a minor or a person of unsound mind or a person disqualified to enter into a contract - Section 11;

(b) Agreement made under a mistake of fact, material to the agreement on the part of the both the parties - Section 20.

(c) An agreement of which the consideration or object is unlawful - Section 23.

(d) If any part of a single consideration for one or more objects, or any one or any part of any one of several considerations for a single object, is unlawful, the agreement is void - Section 24.

(e) An agreement made without consideration subject to three exceptions provided to Section 25.

(f) An agreement in restraint of marriage - Section 26.

(g) An agreement in restraint of trade - Section 27.

(h) An agreement in restraint of legal proceedings - Section 28.

(i) Agreements, the meaning of which is not certain, or capable of being made certain - Section 29.

(j) Agreement by way of wager- Section 30.

(k) An agreement to enter into an agreement in the future.

(l) An agreement to do an act impossible in itself - Section 56(1)

When contract becomes void

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

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

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

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

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

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

Restitution

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

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

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

Contingent Contract (Section 31)

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

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

Rules regarding Contingent Contracts

The following rules are contained in Section 32-36:

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

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

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

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

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

(c) If a contract is contingent upon how a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time or otherwise than under further contingencies - Section 34.

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

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

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

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

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

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

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

CERTAIN RELATIONS RESEMBLING THOSE OF CONTRACT (QUASI CONTRACTS)

Nature of Quasi-Contracts

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

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

Quasi-Contracts or Implied Contracts under the Indian Contract Act

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

(a) Necessaries supplied to person incapable of contracting or to anyone whom he is illegally bound to support - Section 68.

(b) Suit for money had and received - Section 69 and 72.

(c) Obligations of a finder of goods - Section 71.

(d) Obligation of person enjoying benefit of a non-gratuitous act - Section 70

(e) Liability for money paid or thing delivered by mistake or by coercion

(a) Necessaries Supplied to incompetent person

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

(b) Suit for money had and received

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

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

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

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

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

(c) Obligations of finder of lost goods

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

(d) Obligation of a person enjoying benefit of non-gratuitous act

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

(e) Liability for money paid or things delivered by mistake or by coercion :

Under Section 72 of the Act prescribed that a person who has received money or things by mistake or under coercion must repay or return it. However, the word coercion is not necessarily governed by section 15 of this Act. It mean and include oppression, extortion or such other means.

For example a payment of advance tax in excess is refundable by the Income tax Department.

DISCHARGE OR TERMINATION OF CONTRACTS

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

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

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

(b) mutual consent or agreement.

(c) lapse of time;

(d) operation of law;

(e) impossibility of performance; and

(f) breach of contract.

(a) Performance of Contracts (Section 37)

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

Illustration

X promises to deliver a horse to Y on a certain day on payment of Rs 1,000. X dies before that day. X's representatives are bound to deliver the horse to Y and Y is bound is pay ₹ 1,000 to X's representatives.

Tender of Performance *(Section 38)*

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

To be valid, a tender must fulfil the following conditions

(a) it must be unconditional;

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

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

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

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

Who can demand performance?

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

Effect of refusal of party to perform wholly

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

Illustration

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

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

By whom contract must be performed

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

Illustration

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

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

Devolution of Joint Liabilities

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

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

Illustrations

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

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

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

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

Devolution of Joint Rights

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

Assignment

The promisee may assign rights and benefits of contract and the assignee will be entitled to demand performance by the promisor. But the assignment to be complete and effectual, must be made by an instrument in writing.

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

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

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

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

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

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

Rescission – Cancellation of contract by agreement between the parties at any time before it is discharged by performance or in some other way and as a result none requires to perform.

Remission – acceptance of a lesser sum than what was contracted for or a lesser fulfilment of the promise made. In other words discharge to a party by accepting his less performance in lieu of whole.

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

(c) Discharge by Lapes of Time

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

(d) Discharge by Operation of the Law

Discharge under this head may take place as follows:

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

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

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

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

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

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

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

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

(a) Supervening Impossibility

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

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

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

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

(b) Discharge by Supervening Illegality

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

Cases in which there is no supervening impossibility

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

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

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

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

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

(f) Discharge by Breach

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

Anticipatory Breach of Contract

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

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

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

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

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

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

REMEDIES FOR BREACH

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

(i) Remedies for Breach of Contract

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

(a) Rescind the contract and refuse further performance of the contract;

(b) Sue for damages;

(c) Sue for specific performance;

(d) Sue for an injunction to restrain the breach of a negative term; and

(e) Sue on quantum meruit

(a) Rescission of contract

When a party to a contract has broken the contract, the other party may treat the contract as rescinded and he is absolved from all his obligations under the contract. Under Section 65, when a party treats the contract as rescinded, he makes himself liable to restore any benefits he has received under the contract to the party from whom such benefits were received. Under Section 75 of the Indian Contract Act, if a person rightfully rescinds a contract, he is entitled to a compensation for any damage which he has sustained through the non-fulfilment of the contract by the other party. Section 64 deals with consequences of rescission of voidable contracts, i.e., where there is flaw in the consent of one party to the contract. Under this Section when a person at whose option a contract is voidable rescinds, the other party thereto need not perform any promise therein contained in which he is the promisor. The party rescinding a voidable contract shall, if he has received any benefit thereunder, from another party to such contract, restore such benefit so far as may be, to the person from whom it was received.

(b) Damages for Breach of Contract

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

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

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

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

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

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

Unliquidated Damages

Those are of the following kinds:

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

Ordinary Damages

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

Special Damages

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

Exemplary Damages

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

(i) breach of promise to marry; and

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

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

Nominal Damages

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

Liquidated Damages and Penalty

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

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

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

(c) Specific Performance

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

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

Specific performance will not be ordered:

(a) where monetary compensation is an adequate remedy;

(b) where the Court cannot supervise the execution of the contract, e.g., a building contract;

(c) where the contract is for personal service; and

(d) where one of the parties is a minor.

(d) Injunction

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

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

(e) Quantum Meruit

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

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

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

The claim on a quantum meruit arises when one party abandons the contract, or accepts the work done by another under a void contract.

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

CONTRACT OF INDEMNITY AND GUARANTEE (Sections 124 to 147)

Meaning of Indemnity

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

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

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

Rights of Indemnity Holder when Sued

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

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

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

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

Meaning of Contract of Guarantee

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

Illustration

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

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

Illustration

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

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

Distinction between Indemnity and Guarantee

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

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

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

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

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

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

Extent of Surety's Liability

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

Illustration

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

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

Kinds of Guarantees

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

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

Revocation of Continuing Guarantee

A continuing guarantee is revoked in the following circumstances:

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

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

Rights of Surety

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

(a) *Surety's Rights against the Creditor:* Under Section 141 a surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into whether the surety knows of the existence of such security or not; and, if the creditor losses or, without the consent of the surety parts with such security, the surety is discharged to the extent of the value of the security.

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

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

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

Discharge of Surety

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

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

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

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

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

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

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

(g) If the creditor loses or parts with any security which at the time of the contract the debtor had given in favour of the creditor, the surety is discharged to the extent of the value of the security, unless the surety consented to the release of such security by creditor in favour of the debtor. It is immaterial whether the surety was or is aware of such security or not (Section 141).

Illustrations

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

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

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

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

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

CONTRACT OF BAILMENT AND PLEDGE

(a) Bailment

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

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

Gratuitous Bailment

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

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

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

Bailment for Reward

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

Duties of Bailee

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

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

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

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

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

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

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

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

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

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

Bailees Particular Lien *(Section 170)*

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

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

Particular and General Lien

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

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

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

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

Duties of bailor

The bailor has the following duties:

(a) The bailor must disclose all the known faults in the goods; and if he fails to do that, he will be liable for any damage resulting directly from the faults (Section 150). For example, A delivers to B, a carrier, some explosive in a case, but does not warn B. The case is handled without extraordinary care necessary for such articles and explodes. A is liable for all the resulting damage to men and other goods.

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

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

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

Termination of bailment

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

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

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

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

Finder of Lost Goods

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

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

The finder has a right to sell the property –

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

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

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

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

Carrier as Bailee

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

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

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

(b) Pledge

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

The following are the essential ingredients of a pledge:

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

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

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

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

Rights of the Pawnee

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

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

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

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

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

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

Rights of Pawnor

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

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

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

Pledge by Non-owners

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

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

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

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

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

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

LAW OF AGENCY

Definition of Agent (Section 182)

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

Creation of Agency

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

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

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

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

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

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

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

A wife deserted by her husband and thus forced to live separate from him, can pledge her husbands credit to buy all necessaries of life according to the position of the husband even against his wishes.

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

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

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

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

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

(e) Only lawful acts can be ratified.

Classes of Agents

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

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

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

Sub-Agent

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

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

Mercantile Agents

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

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

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

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

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

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

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

Duties of the Agent

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

(a) An agent must act within the scope of the authority conferred upon him and carry out strictly the instructions of the principal (Section 211).

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

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

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

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

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

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

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

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

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

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

Rights of Agents

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

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

As the agent represents the principal, the agent has a right to be indemnified by the principal against all charges, expenses and liabilities properly incurred by him in the course of the agency (Sections 222-223).

Extent of Agent's Authority

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

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

Responsibilities of Principal to Third-parties

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

(i) the agent acts for a named principal;

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

(iii) the agent acts for a concealed principal.

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

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

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

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

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

Principal Liable for Agent's Torts (Section 238)

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

Personal Liability of Agent to Third-party

An agent is personally liable in the following cases:

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

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

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

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

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

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

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

Meaning of Authority Coupled with Interest (Section 202)

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

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

(i) The interest of the agent should exist at the time of creation of agency and should not have arisen after the creation of agency.

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

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

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

Termination of Agency

An agency comes to an end or terminates –

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

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

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

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

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

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

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

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

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

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

When Agency is Irrevocable

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

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

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

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

When Termination Takes Effect

Termination of an agency takes effect or is complete, as regards the agent when it becomes known to the agent. If the principal revokes the agents authority, the revocation will take effect when the agent comes to know of it. As regards the third-parties, the termination takes effect when it comes to their knowledge (Section 208). Thus, if an agent whose authority has been terminated to his knowledge, enters into a contract with a third-party who deals with him bona fide, the contract will be binding on the principal as against the third-party. The termination of an agent's authority terminates the authority of the sub-agent appointed by the agent (Section 210).

The revocation of agency as regards the agent and as regards the principal takes effect at different points of time. Section 209 charges the agent with duty to protect the principal's interest where the principal dies or becomes of unsound mind. It provides that when an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interest entrusted to him. So it is the duty of the agent to take all steps to protect the interest of his deceased principal on his death.

LESSON ROUND UP

- The law relating to contract is governed by the Indian Contract Act, 1872. The Act came into force on the first day of September, 1872.
- The Indian Contract Act mostly deals with the general principles and rules governing contracts.
- An agreement gives birth to a contract.
- As per Section 2(e) of the Indian Contract Act "every promise and every set of promises, forming the consideration for each other, is an agreement.
- According to Section 2(b) of the Indian Contract Act "when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise. An agreement, therefore, comes into existence when one party makes a proposal or offer to the other party and that other party signifies his assent thereto. In nutshell, an agreement is the sum total of offer and acceptance."
- Characteristics of an Agreement
  - Plurality of persons
  - Consensus ad idem
- Where parties have made a binding contract, they have created rights and obligations between themselves.
- Agreements in which the idea of bargain is absent and there is no intention to create legal relations are not contracts.
- The essential elements of a valid contract are :
  - An offer or proposal by one party and acceptance of that offer by another party resulting in an agreement – consensus-ad-idem.
  - An intention to create legal relations or an intent to have legal consequences.
  - The agreement is supported by a lawful consideration.
  - The parties to the contract are legally capable of contracting.
  - Genuine consent between the parties.
  - The object and consideration of the contract is legal and is not opposed to public policy.
  - The terms of the contract are certain.
  - The agreement is capable of being performed i.e., it is not impossible of being performed.
- Flaws in Contract
  - Void Agreement

  - Voidable Contract
  - Illegal Agreement
- The general rule is that all natural persons have full capacity to make binding contracts. But the Indian Contract Act, 1872 admits an exception in the case of:
  - The terms of the contract are certain.
  - minors,
  - lunatics, and
  - persons disqualified from contracting by any law to which they are subject.
- The law says that it will not aid any one to evade consequences on the plea that he was mistaken.
- Misrepresentation ; be either (i) Innocent misrepresentation, or (ii) Wilful misrepresentation with intent to deceive and is called fraud.
- Coercion as defined in Section 15 means "the committing or threatening to commit any act forbidden by the Indian Penal Code, or unlawful detaining or threatening to detain, any property to the prejudice of any person whatever with the intention of causing any person to enter into an agreement".
- Under Section 16 of the Indian Contract Act, 1872, a contract is said to be produced by undue influence "where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other".
- One of the requisites of a valid contract is that the object should be lawful.
- A contract is said to be discharged or terminated when the rights and obligations arising out of a contract are extinguished.
- Contracts may be discharged or terminated by any of the following modes:
  - performance, i.e., by fulfilment of the duties undertaken by parties or, by tender;
  - mutual consent or agreement
  - lapse of time
  - operation of law
  - impossibility of performance
  - breach of contract.
- A contract of indemnity is a contract by which one party promises to save the other party from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person.
- A contract of guarantee is a contract to perform the promise, or discharge the liability of a third person in case of his default.
- A bailment is a transaction whereby one person delivers goods to another person for some purpose, upon a contract that they are, when the purpose is accomplished to be returned or otherwise disposed of according to the directions of the person delivering them.
- Pledge or pawn is a contract whereby an article is deposited with a lender of money or promisee as security for the repayment of a loan or performance of a promise.
- An agent is a person who is employed to bring his principal into contractual relations with third-parties.

GLOSSARY

Agreement	Every promise and every set of promises, forming the consideration for each other, is an agreement.
Consensus ad idem	Meeting of the minds; that is common consent required for a binding contract.
Promisor	A person to whom a promise has been made.
Promisee	One who makes a promise.
Offeror	A person that presents something to somebody for acceptance or rejection.
Offeree	A person to whom an offer is made.
Acceptance	An express act or implication by conduct that manifests assent to the terms of an offer in a manner invited or required by the offer so that a binding contract is formed.
Standing Offers	Agreement under which a vendor allows a buyer to purchase specified goods or services at a predetermined price for a certain period on an 'as and when' requirement basis.
Consideration	When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise. Consideration means *quid pro quo* i.e. something in return.
Donor	A person or entity making a gift or donation.
Donee	A person or organization which receives a gift.
Privity of Contract	Legal doctrine that a contract confers rights and imposes liabilities only on its contracting parties. They, and not any third-party, can sue each other (or be sued) under the terms of the contracts.
Void Agreement	An agreement not enforceable by law is said to be void.
Voidable Contract	An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract.
Illegal Agreement	An agreement having no legal effects as between the immediate parties. Further, transactions collateral to it also become tainted with illegality and are, therefore, not enforceable.
Coercion	The intimidation of a victim to compel the individual to do some act against his or her will by the use of psychological pressure, physical force, or threats.
Fraud	Untrue statement made knowingly or without belief in its truth or recklessly, carelessly, with the intent to deceive.
Alien Enemies	A foreign born citizen or subject of a nation or power that is hostile territory.
Ultra Vires	Beyond the scope, power, authority.

Ignorantia juris non-excusat	Ignorance of law excuses no one.
Uberrimae fidei	Of utmost good faith.
In parti delicto potier est conditio defendeties	Money paid or property transferred under an illegal agreement cannot be recovered.
Ex turpi cause non-oritur action	No action arises from an illegal or immoral cause.
Pari delicto	Equally guilty.
Wagering Agreements	The meaning of 'wagering' is staking something of value upon the result of some future uncertain event, such as a horse race, or upon the ascertainment of the truth concerning some past or present event. Agreements by way of wager are void.
Restitution	The act of restoring to the rightful owner something that has been taken away, lost, or surrendered.
Contingent Contract	A Contract to do or not to do something, if some event, collateral to such Contract, does or does not happen.
Quasi-Contracts	A situation in which there is an obligation as if there was a contract, although the technical requirements of a contract have not been fulfilled.
Quantum meruit	As much as earned or reasonable remuneration.
Novation	The substitution of a new contract for an old one. The new agreement extinguishes the rights and obligations that were in effect under the old agreement.
Rescission	The abrogation of a contract, effective from its inception, thereby restoring the parties to the positions they would have occupied if no contract had ever been formed.
Waiver	The voluntary surrender of a known right; conduct supporting an inference that a particular right has been relinquished. A waiver is essentially a unilateral act of one person that results in the surrender of a legal right.
Specific Performance	An extraordinary equitable remedy that compels a party to execute a contract according to the precise terms agreed upon or to execute it substantially so that, under the circumstances, justice will be done between the parties.
Injunction	A court order by which an individual is required to perform, or is restrained from performing, a particular act. A writ framed according to the circumstances of the individual case.
Indemnity	An indemnity arises when one individual takes on the obligation to pay for any loss or damage that has been or might be incurred by another individual. The right to indemnity and the duty to indemnify ordinarily stem from a contractual agreement, which generally protects against liability, loss, or damage.

Guarantee	One to whom a guaranty is made.
Surety	An individual who undertakes an obligation to pay a sum of money or to perform some duty or promise for another in the event that person fails to act.
Bailment	A "bailment" is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.
Bailor	A person who leaves goods in the custody of another, usually under a "contract of bailment," in which the custodian ("bailee") is responsible for the safekeeping and return of the property.
Bailee	A person also called a custodian, with whom some article is left, usually pursuant to a contract, who is responsible for the safe return of the article to the owner when the contract is fulfilled.
Particular lien	A particular lien is a possessor lien by which the possessor of goods has the right to retain specific goods until a debt incurred with respect to those goods has been paid. A particular lien is a right to retain the property for a charge on account of labor employed or expenses bestowed upon the identical property detained.
General lien	A general lien is a possessor lien used by the lien-holder to retain any of the debtor's goods in the possession of the lien-holder until any debt due from the debtor has been paid. The lien shall be on the charges on the particular goods as well as the general balance of account also.
Pledge	Pledge is special kind of bailment, where delivery of goods is for purpose of security for payment of a debt or performance of a promise.
Pawnor	The bailor in case of pledge is called the pawnor.
Pawnee	The bailee in case of pledge is called the pawnee.
Agent	One who agrees and is authorized to act on behalf of another, a principal, to legally bind an individual in particular business transactions with third parties pursuant to an agency relationship.
Express Agency	A consensual relationship created by contract or by law where one party, the principal, grants authority for another party, the agent, to act on behalf of and under the control of the principal to deal with a third party. An agency relationship is fiduciary in nature, and the actions and words of an agent exchanged with a third party bind the principal.
Implied Agency	An agency relationship that arises out of the conduct of the parties and the impressions they give to the world,rather than because of a written or oral agreement.It is extremely rare to have an implied agency in real estate because of the rule that real estate contracts must be in writing,so agency relationships regarding real estate must also be in writing.

Sub-Agent	A person appointed by an agent to perform some duty, or the whole of the business relating to his agency.
***Del credere* Agent**	A mercantile agent who in consideration of extra remuneration called del credere commission undertakes to indemnify his employer against loss arising from the failure of persons with whom he contracts.
Auctioneers	A person authorized by law to sell the goods of others at public sale.
Caveat emptor	Let the buyers beware.

SELF-TEST QUESTIONS

1. Distinguish between innocent misrepresentation and fraud.
2. Is an immoral agreement necessarily illegal?
3. Can A recover the amount promised to him by B in the following cases?
   (a) A procured B a second wife on B's promise to pay him Rs. 500.
   (b) B has promised to pay A Rs. 1,000 for his horse which had died before the contract
   (c) B, a minor, promised to pay A Rs. 10,000 for his car.
   (d) B promised to pay his son A Rs.,10,000 if he would not marry C.
4. State whether the following statements are true or false:
   (a) An agreement in restraint of trade is always void.
   (b) Wagering agreements are illegal in all parts of India.
   (c) There is no restitution where a minor is a party to a contract.
   (d) A quasi-contract is not a full contract; it is a semi-contract.
   (e) A liability under a contract cannot be assigned.
   (f) Specific performance will be ordered in all cases in which an injunction can be granted.
5. Enumerate the different modes of discharge of a contract.
6. Illustrate the meaning of anticipatory breach of contract.
7. Distinguish between:
   (a) Liquidated and unliquidated damages
   (b) Liquidated damages and penalty
   (c) Indemnity and Guarantee
   (d) Sub-agent and Substituted Agent
8. State whether the following statements are true or false:
   (a) Surety enjoys a right of subrogation.
   (b) Failure to sue the principal debtor within time, discharges the surety.
   (c) Money deposited in fixed deposit with a bank is bailment.

(d) A bailee under a gratuitous bailment need not take as much care of the goods bailed as in case of bailment for reward.

(e) A bailee has a rights of general lien.

(f) A pawnee can sell the goods pawned on default by pawnor.

9. What are the rights and duties of a finder of goods? What is the nature of lien which finder of lost goods has over the goods?
10. State and responsibilities of the principal when he is disclosed, undisclosed, and concealed.
11. When is an agent personally liable for the contracts made by him on behalf of his principal? How agency relationship arises by "ratification" and "estoppel".
12. What is gratuitous bailment? Give illustrations. Described the duties and responsibilities of a bailee.
13. What is meant by ratification? What are the requirements of valid ratification?
14. Distinguish between particular lien and general lien? Who are entitle to general lien?

PRACTICAL PROBLEMS

1. A on board an English ship on the high seas, causes B to enter into an agreement by an act amounting to criminal intimidation under the Indian Penal Code. A afterwards sues B for breach of contract at Calcutta. Has A employed any coercion?
2. X having advanced money to his son Y, during the minority, upon Y's becoming major obtains by misuse of parental influence a bond from Y for a greater amount than the sum due in respect of the advances. Has X employed undue influence?
3. A sells by auction, to B a horse which A knows to be unsound. A says nothing to B about the horses unsoundness. Is A guilty of fraud.
4. A and B are traders and enter into some contract. A has private information of a change in price which would effect B's willingness to proceed with the contract. Is A bound to inform B.

Hints for Answers

1. Yes, A has employed coercion – Refer Section 15 of the Indian Contract Act.
2. Yes, vide Section 16 of the Indian Contract Act.
3. No, vide Section 17 of the Indian Contract Act.
4. No, vide Section 17 of the Indian Contract Act.

Suggested Readings

(1) Indian Contract Act, 1872 – Bare Act

(2) A Manual of Mercantile Law – M.C. Shukla

(3) Law of Contract – Avtar Singh

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Lesson 11
Sale of Goods Act, 1930

LESSON OUTLINE

- Introduction
- Contract of Sale of Goods
- Distinction between
  - Sale and Agreement to Sell
  - Sale and Bailment
  - Sale and Contract for work and Labour
  - Sale and Hire Purchase Agreement
- Subject matter of Contract of Sale of Goods
- Conditions and Warranties
- Doctrine of Caveat Emptor
- Passing of Property or Transfer of Ownership
- Transfer of Title by Person not the Owner
- Performance of the Contract of Sale
- Review Questions
- Unpaid Seller
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

Sale of Goods Act is one of very old mercantile law. Sale of Goods is one of the special types of Contract. Initially, this was part of Indian Contract Act itself. Later, this was deleted in Contract Act, and separate Sale of Goods Act was passed in 1930.

Sale of Goods Act is complimentary to Contract Act. Basic provisions of Contract Act apply to contract of Sale of Goods Act also. Basic requirements of contract i.e. offer and acceptance, legally enforceable agreement, mutual consent, parties competent to contract; free consent, lawful object, consideration etc. apply to contract of Sale of Goods Act also.

This lesson is to be taught after the students have been made familiar with the general principles of contract in which the emphasis is on understanding and appreciating the basic essentials of a valid contract and on the existence of contractual relationship in various instances. In today's era, the need for awareness of buyers and sellers rights is of utmost importance. In the backdrop of this and Contract Act, Sales of Goods Act is taught here to let the buyers beware and sellers to comply the requisite law in better and spirit.

Every sale has five basic obstacles: no need, no money, no hurry, no desire, no trust.

Zig Ziglar

INTRODUCTION

The law relating to sale of goods is contained in the Sale of Goods Act, 1930. It has to be read as part of the Indian Contract Act, 1872 [Sections 2(5) and (3)].

Contract of Sale of Goods

According to Section 4, a contract of sale of goods is a contract whereby the seller:

(i) transfers or agrees to transfer the property in goods,

(ii) to the buyer,

(iii) for a money consideration called the price.

It shows that the expression "contract of sale" includes both a sale where the seller transfers the ownership of the goods to the buyer, and an agreement to sell where the ownership of goods is to be transferred at a future time or subject to some conditions to be fulfilled later on.

The following are thus the essentials of a contract of sale of goods:

(i) *Bilateral contract:* It is a bilateral contract because the property in goods has to pass from one party to another. A person cannot buy the goods himself.

(ii) *Transfer of property:* The object of a contract of sale must be the transfer of property (meaning ownership) in goods from one person to another.

(iii) *Goods:* The subject matter must be some goods.

(iv) *Price or money consideration:* The goods must be sold for some price, where the goods are exchanged for goods it is barter, not sale.

(v) *All essential elements of a valid contract* must be present in a contract of sale.

Distinction between Sale and Agreement to Sell

The following points will bring out the distinction between sale and an agreement to sell:

(a) In a sale, the property in the goods sold passes to the buyer at the time of contract so that he becomes the owner of the goods. In an agreement to sell, the ownership does not pass to the buyer at the time of the contract, but it passes only when it becomes sale on the expiry of certain time or the fulfilment of some conditions subject to which the property in the goods is to be transferred.

(b) An agreement to sell is an executory contract; a sale is an executed contract.

(c) An agreement to sell is a contract pure and simple, but a sale is contract plus conveyance.

(d) If there is an agreement to sell and the goods are destroyed by accident, the loss falls on the seller. In a sale, the loss falls on the buyer, even though the goods are with the seller.

(e) If there is an agreement to sell and the seller commits a breach, the buyer has only a personal remedy against the seller, namely, a claim for damages. But if there has been a sale, and the seller commits a breach by refusing to deliver the goods, the buyer has not only a personal remedy against him but also the other remedies which an owner has in respect of goods themselves such as a suit for conversion or detinue, etc.

Sale and Bailment

A “bailment” is a transaction under which goods are delivered by one person (the bailor) to another (the bailee) for some purpose, upon a contract that they be returned or disposed of as directed after the purpose is accomplished (Section 148 of the Indian Contact Act, 1872).

The property in the goods is not intended to and does not pass on delivery though it may sometimes be the intention of the parties that it should pass in due course. But where goods are delivered to another on terms which indicate that the property is to pass at once the contract must be one of sale and not bailment.

Sale and Contract for Work and Labour

The distinction between a “sale” and a “contract for work and labour” becomes important when question of passing of property arises for consideration.

However, these two are difficult to distinguish. The test generally applied is that if as a result of the contract, property in an article is transferred to one who had no property therein previously for a money consideration, it is a sale, where it is otherwise it is a contract for work and labour.

Sale and Hire Purchase Agreement

“Sale”, is a contract by which property in goods passes from the seller to the buyer for a price.

A “hire purchase agreement” is basically a contract of hire, but in addition, it gives the hirer an option to purchase the goods at the end of the hiring period. Consequently, until the final payment, the hirer is merely a bailee of goods and ownership remains vested in the bailor. Under such a contract, the owner of goods delivers the goods to person who agrees to pay certain stipulated periodical payments as hire charges. Though the possession is with the hirer, the ownership of the goods remains with the original owner.

The essence of hire purchase agreement is that there is no agreement to buy, but only an option is given to the hirer to buy by paying all the instalments or put an end to the hiring and return the goods to the owner, at any time before the exercise of the option.

Since the hirer does not become owner of the goods until he has exercised his option to buy, he cannot pass any title even to an innocent and *bona fide* purchaser. The transaction of hire-purchase protects the owner of the goods against the insolvency of the buyer, for if the buyer becomes insolvent or fails to pay the instalments, he can take back the goods as owner. And if the hirer declines to take delivery of the goods, the remedy of the owner will be damages for non-hiring and not for rent for the period agreed.

It is important to note the difference between a hire purchase agreement and mere payment of the price by instalments because, the latter is a sale, only the payment of price is to be made by instalments.

The distinction between the two is very important because, in a hire-purchase agreement the risk of loss or deterioration of the goods hired lies with the owner and the hirer will be absolved of any responsibility therefor, if he has taken reasonable care to protect the same as a bailee. But it is otherwise in the case of a sale where the price is to be paid in instalments.

Subject matter of Contract of Sale of Goods

(i) *Goods:* The subject matter of the contract of sale is essentially goods. According to Section 2(7) of the Sale of Goods Act, “goods” means every kind of movable property other than actionable claims and money and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.

Actionable claims and money are not goods and cannot be brought and sold under this Act. Money means current money, i.e., the recognised currency in circulation in the country, but not old and rare coins which may be treated as goods. An actionable claim is what a person cannot make a present use of or enjoy, but what can be recovered by him by means of a suit or an action. Thus, a debt due to a man from another is an actionable claim and cannot be sold as goods, although it can be assigned. Under the provisions of the Transfer of Property Act, 1882, goodwill, trade marks, copyrights, patents are all goods, so is a ship. As regards water, gas, electricity, it is doubtful whether they are goods (*Rash Behari* v. *Emperor,* (1936) 41 C.W.N. 225; *M.B. Electric Supply Co. Ltd.* v. *State of Rajasthan,* AIR (1973) Raj. 132).

Goods may be (a) existing, (b) future, or (c) contingent. The existing goods may be (i) specific or generic, (ii) ascertained or unascertained.

(ii) *Existing Goods:* Existing goods are goods which are either owned or possessed by the seller at the time of the contract. Sale of goods possessed but not owned by the seller would be by an agent or pledgee.

Existing goods are specific goods which are identified and agreed upon at the time of the contract of sale. Ascertained goods are either specific goods at the time of the contract or are ascertained or identified to the contract later on i.e. made specific.

Generic or unascertained goods are goods which are not specifically identified but are indicated by description. If a merchant agrees to supply a radio set from his stock of radio sets, it is a contract of sale of unascertained goods because it is not known which set will be delivered. As soon as a particular set is separated or identified for delivery and the buyer has notice of it, the goods are ascertained and become specific goods.

(iii) *Future Goods:* Future goods are goods to be manufactured or produced or acquired by the seller after the making of the contract of sale. A agrees to sell all the mangoes which will be produced in his garden next season. This is an agreement for the sale of future goods. [Section 2(6)]

(iv) *Contingent Goods:* Where there is a contract for the sale of goods, the acquisition of which by the seller depends upon a contingency which may or may not happen–such goods are known as contigent goods. Contigent goods fall in the class of future goods. A agrees to sell a certain TV set provided he is able to get it from its present owner. This is an agreement to sell contigent goods. In such a case, if the contingency does not happen for no fault of the seller, he will not be liable for damages.

Actual sale can take place only of specific goods and property in goods passes from the seller to buyer at the time of the contract, provided the goods are in a deliverable state and the contract is unconditional.

There can be an agreement to sell only in respect of future or contingent goods.

Effect of Perishing of Goods

In a contract of sale of goods, the goods may perish before sale is complete. Such a stage may arise in the following cases:

(i) *Goods perishing before making a contract*

Where in a contract of sale of specific goods, the goods without the knowledge of the seller have, at the time of making the contract perished or become so damaged as no longer to answer to their description in the contract, the contract is void. This is based on the rule that mutual mistake of fact essential to the contract renders the contract void. (Section 7)

If the seller was aware of the destruction and still entered into the contract, he is estopped from disputing the contract. Moreover, perishing of goods not only includes loss by theft but also where the goods have lost their commercial value.

(ii) *Goods perishing after agreement to sell*

Where there is an agreement to sell specific goods, and subsequently the goods without any fault of any party perish or are so damaged as no longer to answer to their description in the agreement before the risk passes to the buyer, the agreement is thereby avoided. The provision applies only to sale of specific goods. If the sale is of unascertained goods, the perishing of the whole quantity of such goods in the possession of the seller will not relieve him of his obligation to deliver. (Section 8)

Price

No sale can take place without a price. Thus, if there is no valuable consideration to support a voluntary surrender of goods by the real owner to another person, the transaction is a gift, and is not governed by the Sale of Goods Act. Therefore, price, which is money consideration for the sale of goods, constitutes the essence for a contract of sale. It may be money actually paid or promised to be paid. If a consideration other than money is to be given, it is not a sale.

Modes of Fixing Price (Sections 9 and 10)

The price may be fixed:

(i) at the time of contract by the parties themselves, or

(ii) may be left to be determined by the course of dealings between the parties, or

(iii) may be left to be fixed in some way stipulated in the contract, or

(iv) may be left to be fixed by some third-party.

Where the contract states that the price is to be fixed by a third-party and such third-party fails to do so, the contract is void. But if the buyer has already taken the benefit of the goods, he must pay a reasonable price for them. If the third-party's failure to fix the price is due to the fault of the seller or buyer, then that party is liable for an action for damages.

Where nothing is said by the parties regarding price, the buyer must pay a reasonable price. What is a reasonable price is a question of fact dependent upon the circumstances of each particular case. Generally, the market price would be a reasonable price.

Conditions and Warranties (Sections 10-17)

The parties are at liberty to enter into a contract with any terms they please. As a rule, before a contract of sale is concluded, certain statements are made by the parties to each other. The statement may amount to a stipulation, forming part of the contract or a mere expression of opinion which is not part of the contract. If it is a statement by the seller on the reliance of which the buyer makes the contract, it will amount to a stipulation. If it is a mere commendation by the seller of his goods it does not amount to a stipulation and does not give the right of action.

The stipulation may either be a condition or a warranty. Section 12 draws a clear distinction between a condition and a warranty. Whether a stipulation is a condition or only a warranty is a matter of substance rather than the form of the words used. A stipulation may be a condition though called a warranty and vice versa.

Conditions

If the stipulation forms the very basis of the contract or is essential to the main purpose of the contract, it is a condition. The breach of the condition gives the aggrieved party a right to treat the contract as repudiated. Thus, if the seller fails to fulfil a condition, the buyer may treat the contract as repudiated, refuse the goods and, if he has already paid for them, recover the price. He can also claim damages for the breach of contract.

Warranties

If the stipulation is collateral to the main purpose of the contract, i.e., is a subsidiary promise, it is a warranty. The effect of a breach of a warranty is that the aggrieved party cannot repudiate the contract but can only claim damages. Thus, if the seller does not fulfil a warranty, the buyer must accept the goods and claim damages for breach of warranty.

Section 11 states that the stipulation as to time of payment are not to be deemed conditions (and hence not to be of the essence of a contract of sale) unless such an intention appears from the contract. Whether any other stipulation as to time (e.g., time of delivery) is of the essence of the contract or not depends on the terms of the contract.

When Condition Sinks to the Level of Warranty

In some cases a condition sinks or descends to the level of a warranty. The first two cases depend upon the will of the buyer, but the third is compulsory and acts as estoppel against him.

(a) A condition will become a warranty where the buyer waives the condition; or

(b) A condition will sink to the level of a warranty where the buyer treats the breach of condition as a breach of warranty; or

(c) Where the contract is indivisible and the buyer has accepted the goods or part thereof, the breach of condition can only be treated as breach of warranty. The buyer can only claim damages and cannot reject the goods or treat the contract as repudiated.

Sometimes the seller may be excused by law from fulfilling any condition or warranty and the buyer will not then have a remedy in damages.

Implied Warranties/Conditions

Even where no definite representations have been made, the law implies certain representations as having been made which may be warranties or conditions. An express warranty or condition does not negative an implied warranty or condition unless inconsistent therewith.

There are two implied warranties:

Implied Warranties [Section 14(b), 14(c) and 16(3)]

(a) *Implied warranty of quiet possession:* If the circumstances of the contract are such as there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods.

(b) *Implied warranty against encumbrances:* There is a further warranty that the goods are not subject to any right in favour of a third-party, or the buyer's possession shall not be disturbed by reason of the existence of encumbrances. This means that if the buyer is required to, and does discharge the amount of the encumbrance, there is breach of warranty, and he is entitled to claim damages from the seller.

Implied Conditions [Sections 14(a), 15(1), (2), 16(1) and Proviso 16(2), and Proviso 16(3) and 12(b) and 12(c)].

Different implied conditions apply under different types of contracts of sale of goods, such as sale by description, or sale by sample, or sale by description as well as sample. The condition, as to title to goods applies to all types of contracts, subject to that there is apparently no other intention.

Implied Conditions as to Title

There is an implied condition that the seller, in an actual sale, has the right to sell the goods, and, in an agreement to sell, he will have a right to sell the goods at the time when property is to pass. As a result, if the title of the seller turns out to be defective, the buyer is entitled to reject the goods and can recover the full price paid by him.

In *Rowland* v. *Divall* (1923) 2 K.B. 500, 'A' had bought a second hand motor car from 'B' and paid for it. After he had used it for six months, he was deprived of it because the seller had no title to it. It was held that 'B' had broken the condition as to title and 'A' was therefore, entitled to recover the purchase money from 'B'

Implied Conditions under a Sale by Description

In a sale by description there are the following implied conditions:

(a) *Goods must correspond with description:* It is provided under Section 15 of the Act that when there is a sale of goods by description, there is an implied condition that the goods shall correspond with description.

In a sale by description, the buyer relies for his information on the description of the goods given by the seller, e.g. in the contract or in the preliminary negotiations.

Where 'A' buys goods which he has not seen, it must be sale by description, e.g., where he buys a 'new Fiat car' from 'B' and the car is not new, he can reject the car.

Even if the buyer has seen the goods, the goods must be in accordance with the description (*Beale* v. *Taylor* (1967) All E.R. 253).

(b) *Goods must also be of merchantable quality:* If they are bought by description from dealer of goods of that description. [Section 16(2)]

Merchantable quality means that the goods must be such as would be acceptable to a reasonable person, having regard to prevailing conditions. They are not merchantable if they have defects which make them unfit for ordinary use, or are such that a reasonable person knowing of their condition would not buy them. 'P' bought black yarn from 'D' and, when delivered, found it damaged by the white ants. The condition of merchantability was broken.

But, if the buyer has examined the goods, there is no implied condition as regards defects which such examination ought to have revealed. If, however, examination by the buyer does not reveal the defect and he approves and accepts the goods, but when put to work, the goods are found to be defective, there is a breach of condition of merchantable quality.

The buyer is given a right to examine the goods before accepting them. But a mere opportunity without an actual examination, however, cursory, would not suffice to deprive him of this right.

(c) *Condition as to wholesomeness:* The provisions, (i.e., eatables) supplied must not only answer the description, but they must also be merchantable and wholesome or sound. 'F' bought milk from 'A' and the milk contained typhoid germs. 'F's wife became infected and died. 'A' was liable for damages. Again, 'C' bought a bun at 'M's bakery, and broke one of his teeth by biting on a stone present in the bun. 'M' was held liable.

(d) *Condition as to quality or fitness for a particular purpose:* Ordinarily, in a contract of sale, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied.

But there is an implied condition that the goods are reasonably fit for the purpose for which they are required if:

(i) the buyer expressly or by implication makes known to the seller the particular purpose for which the goods are required, so as to show that he relies on the seller's skill and judgement, and

(ii) the goods are of a description which it is in the course of the seller's business to supply (whether he is the manufacturer or producer or not). There is no such condition if the goods are bought under a patent or trade name.

In *Priest* v. *Last* (1903) 2 K.B. 148, a hot water bottle was bought by the plaintiff, a draper, who could not be expected to have special skill knowledge with regard to hot water bottles, from a chemist, who sold such articles stating that the bottle will not stand boiling water but was intended to hold hot water. While being used by the plaintiff's wife, the bottle bursted and injured her. *Held,* the seller was responsible for damages as the bottle was not fit for use as a hot water bottle.

In *Grant* v. *Australian Knitting Mills* (1936) 70 MLJ 513, 'G' a doctor purchased woollen underpants from 'M' a retailer whose business was to sell goods of that description. After wearing the underpants, 'G' developed some skin diseases. *Held,* the goods were not fit for their only use and 'G' was entitled to avoid the contract and claim damages.

Implied Conditions under a Sale by Sample (Section 17)

In a contract of sale by sample:

(a) there is an implied condition that the bulk shall correspond with the sample in quality;

(b) there is another implied condition that the buyer shall have a reasonable opportunity of comparing the bulk with the sample;

(c) it is further an implied condition of merchantability, as regards latent or hidden defects in the goods which would not be apparent on reasonable examination of the sample. "Worsted coating" quality equal to sample was sold to tailors, the cloth was found to have a defect in the fixture rendering the same unfit for stitching into coats. The seller was held liable even though the same defect existed in the sample, which was examined.

Implied Conditions in Sale by Sample as Well as by Description

In a sale by sample as well as by description, the goods supplied must correspond both with the samples as well as with the description. Thus, in *Nichol* v. *Godis* (1854) 158 E.R. 426, there was a sale of "foreign refined rape-oil having warranty only equal to sample". The oil tendered was the same as the sample, but it was not "foreign refined rape-oil" having a mixture of it and other oil. It was held that the seller was liable, and the buyer could refuse to accept.

Implied Warranties

Implied warranties are those which the law presumes to have been incorporated in the contract of sale inspite of the fact that the parties have not expressly included them in a contract of sale. Subject to the contract to the contrary, following are the implied warranties in a contract of sale:

(i) *Warranty as to Quiet Possession:* Section 14(b) of the Sale of Goods Act provides that there is an implied warranty that the buyer shall have and enjoy quiet possession of goods. If the buyer's possession is disturbed by anyone having superior title than that of the seller, the buyer is entitled to hold the seller liable for breach of warranty.

(ii) *Warranty as to Freedom from Encumbrances:* Section 14(c) states that in a contract of sale, there is an implied warranty that the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time when the contract is made. But if the buyer is aware of any encumbrance on the goods at the time of entering into the contract, he will not be entitled to any compensation from the seller for discharging the encumbrance.

(iii) *Warranty to Disclose Dangerous Nature of Goods*: If the goods are inherently dangerous or likely to be dangerous and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger.

(iv) *Warranties implied by the custom or usage of trade*: Section 16(3) provides that an implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade.

Doctrine of *Caveat Emptor*

The term *"caveat emptor"* is a Latin word which means "let the buyer beware". This principle states that it is for the buyer to satisfy himself that the goods which he is purchasing are of the quality which he requires. If he buys goods for a particular purpose, he must satisfy himself that they are fit for that purpose. The doctrine of *caveat emptor* is embodied in Section 16 of the Act which states that "subject to the provisions of this Act and of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale". In simple words, it is not the seller's duty to give to the buyer the goods which are fit for a suitable purpose of the buyer. If he makes a wrong selection, he cannot blame the seller if the goods turn out to be defective or do not serve his purpose. The principle was applied in the case of *Ward* v. *Hobbs,* (1878) 4 A.C. 13, where certain pigs were sold by auction and no warranty was given by seller in respect of any fault or error of description. The buyer paid the price for healthy pigs. But they were ill and all but one died of typhoid fever. They also infected some of the buyer's own pigs. It was held that there was no implied condition or warranty that the pigs were of good health. It was the buyer's duty to satisfy himself regarding the health of the pigs.

Exceptions: Section 16 lays down the following exceptions to the doctrine of *Caveat Emptor:*

(1) Where the seller makes a false representation and the buyer relies on it.

(2) When the seller actively conceals a defect in the goods which is not visible on a reasonable examination of the same.

(3) When the buyer, relying upon the skill and judgement of the seller, has expressly or impliedly communicated to him the purpose for which the goods are required.

(4) Where goods are bought by description from a seller who deals in goods of that description.

Passing of Property or Transfer of Ownership (Sections 18-20)

The sole purpose of a sale is the transfer of ownership of goods from the seller to the buyer. It is important to know the precise moment of time at which the property in the goods passes from the seller to the buyer for the following reasons:

(a) The general rule is that risk follows the ownership, whether the delivery has been made or not. If the goods are lost or damaged by accident or otherwise, then, subject to certain exceptions, the loss falls on the owner of the goods at the time they are lost or damaged.

(b) When there is a danger of the goods being damaged by the action of third parties, it is generally the owner who can take action.

(c) The rights of third parties may depend upon the passing of the property if the buyer resells the goods to a third-party, the third-party will only obtain a good title if the property in the goods has passed to the buyer before or at the time of the resale. Similarly, if the seller, in breach of his contract with the buyer, attempts to sell the goods to a third party in the goods, has not passed to the buyer, e.g., where there is only an agreement to sell.

(d) In case of insolvency of either the seller or the buyer, it is necessary to know whether the goods can be taken over by the official assignee or the official receiver. It will depend upon whether the property in the goods was with the party adjudged insolvent.

Thus in this context, ownership and possession are two distinct concepts and these two can at times remain separately with two different persons.

Passing of Property in Specific Goods

In a sale of specific or ascertained goods, the property in them passes to the buyer as and when the parties intended to pass. The intention must be gathered from the terms of the contract, the conduct of the parties and the circumstances of the case.

Unless a contrary intention appears, the following rules are applicable for ascertaining the intention of the parties:

(a) Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made. Deliverable state means such a state that the buyer would be bound to take delivery of the goods. The fact that the time of delivery or the time of payment is postponed does not prevent the property from passing at once. (Section 20)

(b) Where there is a contract for the sale of specific goods not in a deliverable state, i.e., the seller has to do something to the goods to put them in a deliverable state, the property does not pass until that thing is done and the buyer has notice of it. (Section 21)

A certain quantity of oil was brought. The oil was to be filled into casks by the seller and then taken away by the buyer. Some casks were filled in the presence of buyer but, before the remainder could be filled, a fire broke out and the entire quantity of oil was destroyed, *Held,* the buyer must bear the loss of the oil which was put into the casks (i.e., put in deliverable state) and the seller must bear the loss of the remainder (*Rugg* v. *Minett* (1809) 11 East 210).

(c) Where there is a sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do something with reference to the goods for the purpose of ascertaining the price, the property to the goods for the purpose of ascertaining the price, does not pass until such act or thing is done and the buyer has notice of it. (Section 22)

(d) When goods are delivered to the buyer "on approval" or "on sale of return" or other similar terms the property therein passes to the buyer:

(i) when he signifies his approval or acceptance to the seller, or does any other act adopting the transaction;

(ii) if he does not signify his approval or acceptance but retains the goods without giving notice of rejection, in such a case—(a) if a time has been fixed for the return of the goods, on the expiration of such time; and (b) if no time has been fixed, on the expiration of a reasonable time.

Ownership in Unascertained Goods

The property in unascertained or future goods does not pass until the goods are ascertained.

Unascertained goods are goods defined by description only, for example, 100 quintals of wheat; and not goods identified and agreed upon when the contract is made.

Unless a different intention appears, the following rules are applicable for ascertaining the intention of the parties in regard to passing of property in respect of such goods:

(a) The property in unascertained or future goods sold by description passes to the buyer when goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller. Such assent may be expressed or implied and may be given either before or after the appropriation is made. (Section 23)

(b) If there is a sale of a quantity of goods out of a large quantity, for example, 50 quintals of rice out of a heap in B's godown, the property will pass on the appropriation of the specified quantity by one party with the assent of the other.

(c) Delivery by the seller of the goods to a carrier or other buyer for the purpose of transmission to the buyer in pursuance of the contact is an appropriation sufficient to pass the property in the goods.

(d) The property in goods, whether specific or unascertained, does not pass if the seller reserves the right of disposal of the goods. Apart from an express reservation of the right of disposal, the seller is deemed to reserve the right of disposal in the following two cases:

(i) where goods are shipped or delivered to a railway administration for carriage by railway and by the bill of lading or railway receipt, the goods are deliverable to the order of the seller or his agent.

(ii) when the seller sends the bill of exchange for the price of the goods to the buyer for this acceptance, together with the bill of lading, the property in the goods does not pass to the buyer unless he accepts the bill of exchange.

Passing of Risk (Section 26)

The general rule is that goods remain at the seller's risk until the ownership is transferred to the buyer. After the ownership has passed to the buyer, the goods are at the buyer's risk whether the delivery has been made or not. For example, 'A' buys goods of 'B' and property has passed from 'B' to 'A'; but the goods remain in 'B's warehouse and the price is unpaid. Before delivery, 'B's warehouse is burnt down for no fault of 'B' and the goods are destroyed. 'A' must pay 'B' the price of the goods, as he was the owner. The rule is *resperit demino*- the loss falls on the owner.

But the parties may agree that risk will pass at the time different from the time when ownership passed. For example, the seller may agree to be responsible for the goods even after the ownership is passed to the buyer or *vice versa.*

In *Consolidated Coffee Ltd.* v. *Coffee Board,* (1980 3 SCC 358), one of the terms adopted by coffee board for auction of coffee was the property in the coffee knocked down to a bidder would not pass until the payment of price and in the meantime the goods would remain with the seller but at the risk of the buyer, In such cases, risk and property passes on at different stages.

In *Multanmal Champalal* v. *Shah & Co., AIR (1970) Mysore 106,* goods were despatched by the seller from Bombay to Bellary through a public carrier. According to the terms of the contract, the goods were to remain the property of the seller till the price was paid though the risk was to pass to the buyer when they were delivered to public carrier for despatch. When the goods were subsequently lost before the payment of the price (and the consequent to the passing of the property to the buyer), the Court held that the loss was to be borne by the buyer.

It was further held in the same case that the buyer was at fault in delaying delivery unreasonably and therefore on that ground also he was liable for the loss, because such loss would not have arisen but for such delay.

Thus, where delivery has been delayed through the fault of either the buyer or the seller, in such a case, the goods are at the risk of the party at fault as regards any loss which might not have occurred but for such fault.

Transfer of Title by Person not the Owner (Section 27-30)

The general rule is that only the owner of goods can sell the goods. Conversely, the sale of an article by a person who is not or who has not the authority of the owner, gives no title to the buyer. The rule is expressed by the maxim; *"Nemo Dat Quod Non Habet"* i.e. no one can pass a better title than he himself has. As applied to the sale of goods, the rule means that a seller of goods cannot give a better title to the buyer than he himself possess. Thus, even a *bona fide* buyer who buys stolen goods from a thief or from a transfree from such a thief can get no valid title to them, since the thief has no title, nor could he give one to any transferee.

Example:

1. A, the hirer of goods under a hire purchase agreement, sells them to B, then B, though a *bona fide* purchaser, does not acquire the property in the goods. At most he can acquire such an interest as the hirer had.
2. A finds a ring of B and sells it to a third person who purchases it for value and in good faith. The true owner, i.e. B can recover from that person, for A having no title to the ring could pass none the better.

Exception to the General Rule

The Act while recognizing the general rule that no one can give a better title than he himself has, laid down important exceptions to it. Under the exceptions the buyer gets a better title to the goods than the seller himself. These exceptions are given below:

(a) *Sale by a mercantile agent:* A buyer will get a good title if he buys in good faith from a mercantile agent who is in possession either of the goods or documents of title to the goods with the consent of the owner, and who sells the goods in the ordinary course of his business.

(b) *Sale by a co-owner:* A buyer who buys in good faith from one of the several joint owners who is in sole possession of the goods with the permission of his co-owners will get good title to the goods.

(c) *Sale by a person in possession under a voidable contract:* A buyer buys in good faith from a person in possession of goods under a contract which is voidable, but has not been rescinded at the time of the sale.

(d) *Sale by seller in possession after sale:* Where a seller, after having sold the goods, continues or is in possession of the goods or of the documents of title to the goods and again sells them by himself or through his mercantile agent to a person who buys in good faith and without notice of the previous sale, such a buyer gets a good title to the goods.

(e) *Sale by buyer in possession:* If a person has brought or agreed to buy goods obtains, with the seller's consent, possession of the goods or of the documents of title to them, any sale by him or by his mercantile agent to a buyer who takes in good faith without notice of any lien or other claim of the original seller against the goods, will give a good title to the buyer. In any of the above cases, if the transfer is by way of pledge or pawn only, it will be valid as a pledge or pawn.

(f) *Estoppel:* If the true owner stands by and allows an innocent buyer to pay over money to a third-party, who professes to have the right to sell an article, the true owner will be estopped from denying the third-party's right to sell.

(g) *Sale by an unpaid seller:* Where an unpaid seller has exercised his right of lien or stoppage in transit and is in possession of the goods, he may resell them and the second buyer will get absolute right to the goods.

(h) *Sale by person under other laws:* A pawnee, on default of the pawnee to repay, has a right to sell the goods, pawned and the buyer gets a good title to the goods. The finder of lost goods can also sell under certain circumstances. The Official Assignee or Official Receiver, Liquidator, Officers of Court selling under a decree, Executors, and Administrators, all these persons are not owners, but they can convey better title than they have.

Performance of the Contract of Sale

It is the duty of the seller and buyer that the contract is performed. The duty of the seller is to deliver the goods and that of the buyer to accept the goods and pay for them in accordance with the contract of sale.

Unless otherwise agreed, payment of the price and the delivery of the goods and concurrent conditions, i.e., they both take place at the same time as in a cash sale over a shop counter.

Delivery (Sections 33-39)

Delivery is the voluntary transfer of possession from one person to another. Delivery may be actual, constructive or symbolic. *Actual or physical delivery* takes place where the goods are handed over by the seller to the buyer or his agent authorised to take possession of the goods. *Constructive* delivery takes place when the person in possession of the goods acknowledges that he holds the goods on behalf of and at the disposal of the buyer. For example, where the seller, after having sold the goods, may hold them as bailee for the buyer, there is constructive delivery. *Symbolic* delivery is made by indicating or giving a symbol. Here the goods themselves are not delivered, but the "means of obtaining possession" of goods is delivered, e.g, by delivering the key of the warehouse where the goods are stored, bill of lading which will entitle the holder to receive the goods on the arrival of the ship.

Rules as to Delivery

The following rules apply regarding delivery of goods:

(a) Delivery should have the effect of putting the buyer in possession.

(b) The seller must deliver the goods according to the contract.

(c) The seller is to deliver the goods when the buyer applies for delivery; it is the duty of the buyer to claim delivery.

(d) Where the goods at the time of the sale are in the possession of a third person, there will be delivery only when that person acknowledges to the buyer that he holds the goods on his behalf.

(e) The seller should tender delivery so that the buyer can take the goods. It is no duty of the seller to send or carry the goods to the buyer unless the contract so provides. But the goods must be in a deliverable state at the time of delivery or tender of delivery. If by the contract the seller is bound to send the goods to the buyer, but no time is fixed, the seller is bound to send them within a reasonable time.

(f) The place of delivery is usually stated in the contract. Where it is so stated, the goods must be delivered at the specified place during working hours on a working day. Where no place is mentioned, the goods are to be delivered at a place at which they happen to be at the time of the contract of sale and if not then in existence they are to be delivered at the place at which they are manufactured or produced.

(g) The seller has to bear the cost of delivery unless the contract otherwise provides. While the cost of obtaining delivery is said to be of the buyer, the cost of the putting the goods into deliverable state must be borne by the seller. In other words, in the absence of an agreement to the contrary, the expenses of and incidental to making delivery of the goods must be borne by the seller, the expenses of and incidental to receiving delivery must be borne by the buyer.

(h) If the goods are to be delivered at a place other than where they are, the risk of deterioration in transit will, unless otherwise agreed, be borne by the buyer.

(i) Unless otherwise agreed, the buyer is not bound to accept delivery in instalments.

Acceptance of Goods by the Buyer

Acceptance of the goods by the buyer takes place when the buyer:

(a) intimates to the seller that he has accepted the goods; or

(b) retains the goods, after the lapse of a reasonable time without intimating to the seller that he has rejected them; or

(c) does any act on the goods which is inconsistent with the ownership of the seller, e.g., pledges or resells. If the seller sends the buyer a larger or smaller quantity of goods than ordered, the buyer may:

  (a) reject the whole; or

  (b) accept the whole; or

  (c) accept the quantity be ordered and reject the rest.

If the seller delivers with the goods ordered, goods of a wrong description, the buyer may accept the goods ordered and reject the rest, or reject the whole.

Where the buyer rightly rejects the goods, he is not bound to return the rejected goods to the seller. It is sufficient if he intimates the seller that he refuses to accept them. In that case, the seller has to remove them.

Installment Deliveries

When there is a contract for the sale of goods to be delivered by stated instalments which are to be separately paid for, and either the buyer or the seller commits a breach of contract, it depends on the terms of the contract whether the breach is a repudiation of the whole contract or a severable breach merely giving right to claim for damages.

Suits for Breach of Contract

Where the property in the goods has passed to the buyer, the seller may sue him for the price.

Where the price is payable on a certain day regardless of delivery, the seller may sue for the price, if it is not paid on that day, although the property in the goods has not passed.

Where the buyer wrongfully neglects or refuses to accept the goods and pay for them, the seller may sue the buyer for damages for non-acceptance.

Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue him for damages for non-delivery.

Where there is a breach of warranty or where the buyer elects or is compelled to treat the breach of condition as a breach of warranty, the buyer cannot reject the goods. He can set breach of warranty in extinction or dimunition of the price payable by him and if loss suffered by him is more than the price he may sue for the damages.

If the buyer has paid the price and the goods are not delivered, the buyer can sue the seller for the recovery of the amount paid. In appropriate cases the buyer can also get an order from the court that the specific goods ought to be delivered.

Anticipatory Breach

Where either party to a contract of sale repudiates the contract before the date of delivery, the other party may either treat the contract as still subsisting and wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach.

In case the contract is treated as still subsisting it would be for the benefit of both the parties and the party who had originally repudiated will not be deprived of:

(a) his right of performance on the due date in spite of his prior repudiation; or

(b) his rights to set up any defence for non-performance which might have actually arisen after the date of the prior repudiation.

Measure of Damages

The Act does not specifically provide for rules as regards the measure of damages except by stating that nothing in the Act shall affect the right of the seller or the buyer to recover interest or special damages in any case were by law they are entitled to the same. The inference is that the rules laid down in Section 73 of the Indian Contract Act will apply.

REVIEW QUESTIONS

Fill in the Blanks:

1. In the right of lien, the possession is retained by ....

2. According to the Consumer Protection Act of 1986, goods means as defined under ....

3. A club or a society is an .... of persons

4. The registration for partnership firm is ....

State True or Fasle:

5. Unenforceable agreements and illegal agreements mean one and the same thing.

6. The relation between a doctor and his patient is not fiduciary in nature.

Answers: 1. Unpaid seller 2. Sale of Goods Act, 1930 3. Association 4. Not compulsory 5. False 6. False

Unpaid Seller (Sections 45-54)

Who is an unpaid seller? (Section 45)

The seller of goods is deemed to be unpaid seller:

(a) When the whole of the price has not been paid or tendered; or

(b) When a conditional payment was made by a bill of exchange or other negotiable instrument, and the instrument has been dishonoured.

Rights of an Unpaid Seller against the Goods

An unpaid seller's right against the goods are:

(a) A lien or right of retention

(b) The right of stoppage in transit.

(c) The right of resale.

(d) The right to withhold delivery.

(a) *Right of Lien* (Sections 47-49 and 54) An unpaid seller in possession of goods sold, may exercise his lien on the goods, i.e., keep the goods in his possession and refuse to deliver them to the buyer until the fulfilment or tender of the price in cases where:

(i) the goods have been sold without stipulation as to credit; or

(ii) the goods have been sold on credit, but the term of credit has expired; or

(iii) the buyer becomes insolvent.

The lien depends on physical possession. The seller's lien is *possessory lien,* so that it can be exercised only so long as the seller is in possession of the goods. It can only be exercised for the non-payment of the price and not for any other charges.

A lien is lost –

(i) When the seller delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer, without reserving the right of disposal of the goods;

(ii) When the buyer or his agent lawfully obtains possession of the goods;

(iii) By waiver of his lien by the unpaid seller.

(b) *Stoppage in transit* (Sections 50-52) The right of stoppage in transit is a right of stopping the goods while they are in transit, resuming possession of them and retaining possession until payment of the price.

The right to stop goods is available to an unpaid seller

(i) when the buyer becomes insolvent; and

(ii) the goods are in transit.

The buyer is insolvent if he has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due. It is not necessary that he has actually been declared insolvent by the court.

The goods are in transit from the time they are delivered to a carrier or other bailee like a wharfinger or warehouse keeper for the purpose of transmission to the buyer and until the buyer takes delivery of them.

The transit comes to an end in the following cases:

(i) If the buyer obtains delivery before the arrival of the goods at their destination;

(ii) If, after the arrival of the goods at their destination, the carrier acknowledges to the buyer that he holds the goods on his behalf, even if further destination of the goods is indicated by the buyer;

(iii) If the carrier wrongfully refuses to deliver the goods to the buyer.

If the goods are rejected by the buyer and the carrier or other bailee holds them, the transit will be deemed to continue even if the seller has refused to receive them back.

The right to stop in transit may be exercised by the unpaid seller either by taking actual possession of the goods or by giving notice of the seller's claim to the carrier or other person having control of the goods. On notice being given to the carrier, he must redeliver the goods to the seller who must pay the expenses of the redelivery.

The seller's right of lien or stoppage in transit is not affected by any sale on the part of the buyer unless the seller has assented to it. A transfer, however, of the bill of lading or other document of seller to a bona fide purchaser for value is valid against the seller's right.

(c) *Right of re-sale* (Section 54): The unpaid seller may re-sell:

(i) where the goods are perishable;

(ii) where the right is expressly reserved in the contract;

(iii) where in exercise of right of lien or stoppage in transit, the seller gives notice to the buyer of his intention to re-sell, and the buyer, does not pay or tender the price within a reasonable time.

If on a re-sale, there is a deficiency between the price due and amount realised, he is entitled to recover it from the buyer. If there is a surplus, he can keep it. He will not have these rights if he has not given any notice and he will have to pay the buyer profit, if any, on the resale.

(d) *Rights to withhold Delivery:* If the property in the goods has passed, the unpaid seller has right as described above. If, however, the property has not passed, the unpaid seller has a right of withholding delivery similar to and co-extensive with his rights of lien and stoppage in transit.

Rights of an unpaid seller against the buyer (Sections 55 and 56)

An unpaid seller may sue the buyer for the price of the goods in case of breach of contract where the property in the goods has passed to the buyer or he has wrongfully refused to pay the price according to the terms of the contract.

The seller may sue the buyer even if the property in the goods has not passed where the price is payable on a certain day.

Under Section 56, the seller may sue the buyer for damages or breach of contract where the buyer wrongfully neglects or refuses to accept and pay for the goods.

Thus an unpaid sellers rights against the buyer personally are:

(a) a suit for the price.

(b) a suit for damages.

Auction Sales (Section 64)

A sale by auction is a public sale where goods are offered to be taken by bidders. It is a proceeding at which people are invited to complete for the purchase of property by successive offer of advancing sums.

Section 64 lays down the rules regulating auction sales. Where goods are put up for sale in lots, each, lot is *prima facie* deemed to be the subject of a separate contract of sale. The sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner. Until such announcement is made, any bidder may retract his bid.

A right to bid may be reserved expressly by or on behalf of the seller. Where such right is expressly so reserved, the seller or any other person on his behalf may bid at the auction. Where the sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person. Any sale in contravention of this rule may be treated as fraudulent by the buyer. The sale may be notified to be subject to a reserved price. Where there is such notification, every bid is a conditional offer subject to its being up to the reserve price. Where an auctioneer inadvertently knocks down to a bidder who has bid less than the reserved price, there is no contract of sale. If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

Trading Contracts Involving Rail or Sea Transit

In the case of a contract for the sale of goods which are to be shipped by sea a number of conditions are attached by the parties or by custom and practice of merchants. Some of the important types of such contracts are given below:

(a) *F.O.B.(Free on Board):* Under an F.O.B. contract, it is the duty of the seller to put the goods on board a ship at his own expenses. The property in goods passes to the buyer only after the goods have been put on board the ship, and they are at buyer's risk as soon as they are put on board the ship, usually named by the buyer. The seller must notify the buyer immediately that the goods have been delivered on board, so that the buyer may insure them. If he fails to do so the goods shall be deemed to be at seller's risk during such sea transit.

(b) *F.O.R. (Free on Rail):* Similar position prevails in these contracts as in the case of F.O.B. contracts.

(c) *C.I.F. or C.F.I. (Cost Insurance and Freight):* A CIF contract is a contract for the sale of insured goods lost or not lost to be implemented by transfer of proper documents.

In such types of contracts, the seller not only bears all the expenses of putting the goods on board the ship as in an F.O.B. contract, but also to bear the freight and insurance charges. He will arrange for an insurance of the goods for the benefit of the buyer. On the tender of documents, the buyer is required to pay and then take delivery. He has a right to reject the goods if they are not according to the contract.

(d) *Ex-Ship:* Here the seller is bound to arrange the shipment of the goods to the port of destination, and to such further inland destination as the buyer may stipulate. The buyer is not bound to pay until the goods are ready for unloading from the ship and all freight charges paid. The goods travel at the seller's risk, but he is not bound to insure them.

LESSON ROUND UP

– The law relating to sale of goods is contained in the Sale of Goods Act, 1930. It has to be read as part of the Indian Contract Act, 1872.

– A contract of sale of goods is a contract whereby the seller:

  - transfers or agrees to transfer the property in goods
  - to the buyer
  - for a money consideration called the price
  - The following are thus the essentials of a contract of sale of goods:
  - Bilateral contract
  - Transfer of property
  - Goods
  - Price or money consideration
  - All essential elements of a valid contract must be present in a contract of sale.

– In a sale, the property in the goods sold passes to the buyer at the time of contract so that he becomes the owner of the goods. In an agreement to sell, the ownership does not pass to the buyer at the time of the contract, but it passes only when it becomes sale on the expiry of certain time or the fulfilment of some conditions subject to which the property in the goods is to be transferred.

– Where goods are delivered to another on terms which indicate that the property is to pass at once the contract must be one of sale and not bailment.

– A "hire purchase agreement" is basically a contract of hire that gives the hirer an option to purchase the goods at the end of the hiring period.

– The subject matter of the contract of sale is essentially goods. According to Section 2(7) of the Sale of Goods Act, "goods" means every kind of movable property other than actionable claims and money and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale. Goods may be (a) existing, (b) future, or (c) contingent. The existing goods may be (i) specific or generic, (ii) ascertained or unascertained.

– No sale can take place without a price. The price may be fixed:
  - at the time of contract by the parties themselves
  - may be left to be determined by the course of dealings between the parties
  - may be left to be fixed in some way stipulated in the contract
  - may be left to be fixed by some third-party.
– The parties are at liberty to enter into a contract with any terms they please. Before a contract, certain statements are made by the parties to each other. The statement may amount to a stipulation. Stipulation may either be a condition or a warranty.
– The sole purpose of a sale is the transfer of ownership of goods from the seller to the buyer. The general rule is that only the owner of goods can sell the goods. Conversely, the sale of an article by a person who is not or who has not the authority of the owner, gives no title to the buyer.
– It is the duty of the seller and buyer that the contract is performed. The duty of the seller is to deliver the goods and that of the buyer to accept the goods and pay for them in accordance with the contract of sale.
– Unless otherwise agreed, payment of the price and the delivery of the goods and concurrent conditions, i.e., they both take place at the same time as in a cash sale over a shop counter.
– Delivery is the voluntary transfer of possession from one person to another. Delivery may be actual, constructive or symbolic.
– Acceptance of the goods by the buyer takes place when the buyer:
  - intimates to the seller that he has accepted the goods
  - retains the goods
  - does any act on the goods which is inconsistent with the ownership of the seller.
– The seller of goods is deemed to be unpaid seller:
  - When the whole of the price has not been paid or tendered
  - When a conditional payment was made by a bill of exchange or other negotiable instrument, and the instrument has been dishonored.
– An unpaid seller's right against the goods are:

  (a) A lien or right of retention.

  (b) The right of stoppage in transit.

  (c) The right of resale.

  (d) The right to withhold delivery.
– A sale by auction is a public sale where goods are offered to be taken by bidders. It is a proceeding at which people are invited to complete for the purchase of property by successive offer of advancing sums.

GLOSSARY

Bilateral Contract	An agreement formed by an exchange of a promise in which the promise of one party is consideration supporting the promise of the other party.
Goods	According to Section 2(7) of the Sale of Goods Act, "goods" means every kind of movable property other than actionable claims and money and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.
Existing Goods	Existing goods are goods which are either owned or possessed by the seller at the time of the contract.
Generic Goods	Generic or unascertained goods are goods which are not specifically identified but are indicated by description.
Specific Goods	Specific goods are identified and agreed upon at the time of the contract of sale.
Future Goods	Future goods are goods to be manufactured or produced or acquired by the seller after the making of the contract of sale.
Contingent Goods	Where there is a contract for the sale of goods, the acquisition of which by the seller depends upon a contingency which may or may not happen–such goods are known as contigent goods.
Conditions	If the stipulation forms the very basis of the contract or is essential to the main purpose of the contract, it is a condition.
Warranties	If the stipulation is collateral to the main purpose of the contract, i.e., is a subsidiary promise, it is a warranty.
Estoppel	Estoppel precludes a person from asserting something contrary to what is implied by his or her previous action or statement or by a previous judicial determination concerning that person.
Encumbrances	An encumbrance, as it pertains to real estate, means anything that burdens title to the property. An encumbrance can be a mortgage (loan), a lien (voluntary or non voluntary) an easement or a restriction that limits the title.
Nemo Dat Quod Non Habet	If translated literally means no one can give what they do not have. What it actually means in a legal context is that no one can transfer a better title than the one they have.
Constructive Delivery	Constructive delivery takes place when the person in possession of the goods acknowledges that he holds the goods on behalf of and at the disposal of the buyer.
Symbolic Delivery	Symbolic delivery is made by indicating or giving a symbol. Here the goods themselves are not delivered, but the "means of obtaining possession" of goods is delivered. It is the delivery of property by means of a token.
Bill of Lading	A document signed by a carrier (a transporter of goods) or the carrier's representative and issued to a consignor (the shipper of goods) that evidences the receipt of goods for shipment to a specified designation and person.

SELF-TEST QUESTIONS

1. Define contract of sale of goods and distinguish between sale and agreement to sell and hire purchase agreement.
2. Write short notes on:
   (i) Existing goods,
   (ii) Future goods,
   (iii) Contingent goods.
3. Define and distinguish between a condition and a warranty. Under what circumstances a breach of condition is to be treated as a breach of warranty.
4. Why it is important to know the time of passing of property? What are the rights of an unpaid seller against the goods and against the buyer?
5. Explain the following:
   (i) Doctrine of *Caveat emptor.*
   (ii) Doctrine of *'Nemo dat quod non habet'.*
6. Discuss the rights of an unpaid seller.
7. State with reasons whether the purchaser will acquire a good title to the goods in the following cases:
   (a) A and B are co-owners of a T.V. while the T.V. is in possession of B. A secretary takes it away and sells it to C, a bonafide purchaser for value.
   (b) X by way of undue influence buys a car from Y at a very low price and sells it to Z, an innocent purchaser.

Suggested Readings

(1) The Sale of Goods Act, 1930 – *Bare Act*

(2) Manual of Merchantile Law – *M.C. Shukla*

(3) The Indian Contract Act, Sale of Goods Act and Partnership Act – *T.R. Desai Revised by K.H. Kaji, S.C. Sarkar & Sons, Calcutta*

Lesson 12
Negotiable Instruments Act, 1881

LESSON OUTLINE

- Definition of a Negotiable Instrument
- Important Characteristics of Negotiable Instruments
- Classification of Negotiable Instruments
- Review Questions
- Kinds of Negotiable Instruments
  - Promissory Notes
  - Bills of Exchange
  - Cheques
- Modes of Crossing
- Review Questions
- Negotiation
- Importance of Delivery
- Endorsement
- Acceptance of a Bill of Exchange
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

Sale Exchange of goods and services is the basis of every business activity. Goods are bought and sold for cash as well as on credit. All these transactions require flow of cash either immediately or after a certain time. In modern business, large number of transactions involving huge sums of money takes place everyday. It is quite inconvenient as well as risky for either party to make and receive payments in cash. Therefore, it is a common practice for businessmen to make use of certain documents as means of making payment. Some of these documents are called negotiable instruments. But on the other hand, accepting payment using negotiable instruments is no less than a risky transaction since it involves deferred payments. In the light of this, the Negotiable Instruments Act was passed in 1881. There is no doubt that the Act is to regulate commercial transactions and was drafted to suit requirements of business conditions prevailing then.

This lesson deals with the common provisions of the mentioned act, which has played an important role in increasing commercial activities.

The two most beautiful words in the English language are 'check enclosed'

Dorothy Parker

DEFINITION OF A NEGOTIABLE INSTRUMENT

The law relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881. It is an Act to define and amend the law relating to promissory notes, bills of exchange and Cheques.

The Act does not affect the custom or local usage relating to an instrument in oriental language i.e., a Hundi.

The term *"negotiable instrument"* means a document transferable from one person to another. However the Act has not defined the term. It merely says that "A negotiable instrument" means a promissory note, bill of exchange or Cheque payable either to order or to bearer. [Section 13(1)]

A negotiable instrument may be defined as "an instrument, the property in which is acquired by anyone who takes it bona fide, and for value, notwithstanding any defect of title in the person from whom he took it, from which it follows that an instrument cannot be negotiable unless it is such and in such a state that the true owner could transfer the contract or engagement contained therein by simple delivery of instrument" (*Willis—The Law of Negotiable Securities, Page 6*).

According to this definition the following are the conditions of negotiability:

(i) The instrument should be freely transferable. An instrument cannot be negotiable unless it is such and in such state that the true owner could transfer by simple delivery or endorsement and delivery.

(ii) The person who takes it for value and in good faith is not affected by the defect in the title of the transferor.

(iii) Such a person can sue upon the instrument in his own name.

Negotiability involves two elements namely, transferability free from equities and transferability by delivery or endorsement (Mookerjee J. In *Tailors Priya* v. *Gulab Chand*, AIR 1965 Cal).

But the Act recognises only three types of instruments viz., a Promissory Note, a Bill of Exchange and a Cheque as negotiable instruments. However, it does not mean that other instruments are not negotiable instruments provided that they satisfy the following conditions of negotiability:

1. The instrument should be freely transferable by the custom of trade. Transferability may be by (i) delivery or (ii) endorsement and delivery.
2. The person who obtains it in good faith and for consideration gets it free from all defects and can sue upon it in his own name.
3. The holder has the right to transfer. The negotiability continues till the maturity.

Effect of Negotiability

The general principle of law relating to transfer of property is that no one can pass a better title than he himself has *(nemodat quad non-habet).* The exceptions to this general rule arise by virtue of statute or by a custom. A negotiable instrument is one such exception which is originally a creation of mercantile custom.

Thus a *bona fide* transferee of negotiable instrument for consideration without notice of any defect of title, acquires the instrument free of any defect, i.e., he acquires a better title than that of the transferor.

Important Characteristics of Negotiable Instruments

Following are the important characteristics of negotiable instruments:

(1) The holder of the instrument is presumed to be the owner of the property contained in it.

(2) They are freely transferable.

(3) A holder in due course gets the instrument free from all defects of title of any previous holder.

(4) The holder in due course is entitled to sue on the instrument in his own name.

(5) The instrument is transferable till maturity and in case of cheques till it becomes stale (on the expiry of 6 months from the date of issue).

(6) Certain equal presumptions are applicable to all negotiable instruments unless the contrary is proved.

CLASSIFICATION OF NEGOTIABLE INSTRUMENTS

The negotiable instruments may be classified as under:

(i) ***Bearer Instruments:*** A promissory note, bill of exchange or cheque is payable to bearer when (i) it is expressed to be so payable, or (ii) the only or last endorsement on the instrument is an endorsement in blank. A person who is a holder of a bearer instrument can obtain the payment of the instrument.

(ii) ***Order Instruments:*** A promissory note, bill of exchange or cheque is payable to order (i) which is expressed to be so payable; or (ii) which is expressed to be payable to a particular person, and does not contain any words prohibiting transfer or indicating an intention that it shall not be transferable.

(iii) ***Inland Instruments (Section 11):*** A promissory note, bill of exchange or cheque drawn or made in India, and made payable, or drawn upon any person, resident in India shall be deemed to be an inland instrument. Since a promissory note is not drawn on any person, an inland promissory note is one which is made payable in India. Subject to this exception, an inland instrument is one which is either:

(a) drawn and made payable in India, or

(b) drawn in India upon some persons resident therein, even though it is made payable in a foreign country.

(iv) ***Foreign Instruments:*** An instrument which is not an inland instrument, is deemed to be a foreign instrument. The essentials of a foreign instrument include that:

(a) it must be drawn outside India and made payable outside or inside India; or

(b) it must be drawn in India and made payable outside India and drawn on a person resident outside India.

(v) ***Demand Instruments (Section 19):*** A promissory note or a bill of exchange in which no time for payment is specified is an instrument payable on demand.

(vi) ***Time Instruments:*** Time instruments are those which are payable at sometime in the future. Therefore, a promissory note or a bill of exchange payable after a fixed period, or after sight, or on specified day, or on the happening of an event which is certain to happen, is known as a time instrument. The expression “after sight” in a promissory note means that the payment cannot be demanded on it unless it has been shown to the maker. In the case of bill of exchange, the expression “after sight” means after acceptance, or after noting for non-acceptance or after protest for non-acceptance.

(vii) ***Ambiguous Instruments (Section 17):*** An instrument, which in form is such that it may either be treated by the holder as a bill or as a note, is an ambiguous instrument. Section 5(2) of the English Bills of Exchange Act provides that where in a bill, the drawer and the drawee are the same person or where the drawee is a fictitious person or a person incompetent to contract, the holder may treat the instrument, at his option, either as a bill of exchange or as a promissory note.

Bill drawn to or to the order of the drawee or by an agent on his principal, or by one branch of a bank on another or by the direction of a company or their cashier are also ambiguous instruments. A promissory note addressed to a third person may be treated as a bill by such person by accepting it, while a bill not addressed to any one may be treated as a note. But where the drawer and payee are the same,e.g., where A draws a bill payable to A’s order, it is not an ambiguous instrument and cannot be treated as a promissory note. Once an instrument has been treated either as a bill or as a note, it cannot be treated differently afterwards.

(viii) ***Inchoate or Incomplete Instrument (Section 20):*** When one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments, and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives *prima facie* authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein, and not exceeding the amount, covered by the stamp. Such an instrument is called an inchoate instrument. The person so signing shall be liable upon such instrument, in the capacity in which he signs the same, to any holder in due course for such amount, provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended by him to be paid thereon.

The authority to fill up a blank or incomplete instrument may be exercised by any "holder" and not only the first holder to whom the instrument was delivered. The person signing and delivering the paper is liable both to a "holder" and a "holder-in-due- course". But there is a difference in their respective rights. A "holder" can recover only what the person signing and delivering the paper agreed to pay under the instrument, while a "holder-in-due-course" can recover the whole amount made payable by the instrument provided that it is covered by the stamp, even though the amount authorised was smaller.

REVIEW QUESTIONS

Tick (✓) mark for the right answer:

1. A negotiable instrument is freely transferable. Yes/No.
2. A bill of exchange must be in writing. Yes/No.
3. There must always be three different parties in a bill of exchange. Yes/No.
4. 'Holder' and 'Holder in Due Course' carry the same meaning. Yes/No.

Answers: 1. Yes 2. Yes 3. Yes 4. No

KINDS OF NEGOTIABLE INSTRUMENTS

The Act recognises only three kinds of negotiable instruments under Section 13 but it does not exclude any other negotiable instrument provided the instrument entitles a person to a sum of money and is transferable by delivery. Instruments written in oriental languages i.e. hundis are also negotiable instruments. These instruments are discussed below:

(i) Promissory Note

A "promissory note" is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money to, or to the order of, a certain person, or only to bearer of the instrument. (Section 4)

Parties to a Promissory Note:

A promissory note has the following parties:

(a) *The Maker:* the person who makes or executes the note promising to pay the amount stated therein.

(b) *The Payee:* one to whom the note is payable.

(c) *The Holder:* is either the payee or some other person to whom he may have endorsed the note.

(d) *The Endorser.*

(e) *The Endorsee.*

Essentials of a Promissory Note

To be a promissory note, an instrument must possess the following essentials:

(a) It must be in writing. An oral promise to pay will not do.

(b) It must contain an express promise or clear undertaking to pay. A promise to pay cannot be inferred. A mere acknowledgement of debt is not sufficient. If A writes to B "I owe you (I.O.U.) Rs. 500", there is no promise to pay and the instrument is not a promissory note.

(c) The promise or undertaking to pay must be unconditional. A promise to pay "when able", or "as soon as possible", or "after your marriage to D", is conditional. But a promise to pay after a specific time or on the happening of an event which must happen, is not conditional, e.g. "I promise to pay Rs. 1,000 ten days after the death of B", is unconditional.

(d) The maker must sign the promissory note in token of an undertaking to pay to the payee or his order.

(e) The maker must be a certain person, i.e., the note must show clearly who is the person engaging himself to pay.

(f) The payee must be certain. The promissory note must contain a promise to pay to some person or persons ascertained by name or designation or to their order.

(g) The sum payable must be certain and the amount must not be capable of contingent additions or subtractions. If A promises to pay Rs. 100 and all other sums which shall become due to him, the instrument is not a promissory note.

(h) Payment must be in legal money of the country. Thus, a promise to pay Rs. 500 and deliver 10 quintals of rice is not a promissory note.

(i) It must be properly stamped in accordance with the provisions of the Indian Stamp Act. Each stamp must be duly cancelled by maker's signature or initials.

(j) It must contain the name of place, number and the date on which it is made. However, their omission will not render the instrument invalid, e.g. if it is undated, it is deemed to be dated on the date of delivery.

Note : A promissory note cannot be made payable or issued to bearer, no matter whether it is payable on demand or after a certain time (Section 31 of the RBI Act).

(ii) Bills of Exchange

A "bill of exchange" is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of, a certain person or to the bearer of the instrument. (Section 5)

The definition of a bill of exchange is very similar to that of a promissory note and for most of the cases the rules which apply to promissory notes are in general applicable to bills. There are however, certain important points of distinction between the two.

Parties to Bills of Exchange

The following are parties to a bill of exchange:

(a) *The Drawer:* The person who draws the bill.

(b) *The Drawee:* The person on whom the bill is drawn.

(c) *The Acceptor:* One who accepts the bill. Generally, the drawee is the acceptor but a stranger may accept it on behalf of the drawee.

(d) *The Payee:* One to whom the sum stated in the bill is payable, either the drawer or any other person may be the payee.

(e) *The Holder:* Is either the original payee or any other person to whom, the payee has endorsed the bill. In case of a bearer bill, the bearer is the holder.

(f) *The Endorser:* When the holder endorses the bill to any one else he becomes the endorser.

(g) *The Endorsee:* Is the person to whom the bill is endorsed.

(h) *Drawee in case of Need:* Besides the above parties, another person called the "drawee in case of need", may be introduced at the option of the drawer. The name of such a person may be inserted either by the drawer or by any endorser in order that resort may be had to him in case of need, i.e., when the bill is dishonoured by either non-acceptance or non-payment.

(i) *Acceptor for Honour:* Further, any person may voluntarily become a party to a bill as acceptor. A person, who on the refusal by the original drawee to accept the bill or to furnish better security, when demanded by the notary, accept the bill supra protest in order to safeguard the honour of the drawer or any endorser, is called the acceptor for honour.

Essentials of a Bill of Exchange:

(1) It must be in writing.

(2) It must contain an unconditional order to pay money only and not merely a request.

(3) It must be signed by the drawer.

(4) The parties must be certain.

(5) The sum payable must also be certain.

(6) It must comply with other formalities e.g. stamps, date, etc.

Distinction between Bill of Exchange and Promissory Note

The following are the important points of distinction between a bill of exchange and a promissory note:

(a) A promissory note is a two-party instrument, with a maker (debtor) and a payee (creditor). In a bill there are three parties–drawer, drawee and payee, though any two out of the three capacities may be filled by one and the same person. In a bill, the drawer is the maker who orders the drawee to pay the bill to a person called the payee or to his order. When the drawee accepts the bill he is called the acceptor.

(b) A note cannot be made payable to the maker himself, while in a bill, the drawer and payee may be the same person.

(c) A note contains an unconditional promise by the maker to pay to the payee or his order; in a bill there is an unconditional order to the drawee to pay according to the directions of the drawer.

(d) A note is presented for payment without any prior acceptance by the maker. A bill payable after sight must be accepted by the drawee or someone else on his behalf before it can be presented for payment.

(e) The liability of the maker of a pro-note is primary and absolute, but the liability of the drawer of a bill is secondary and conditional.

(f) Foreign bill must be protested for dishonour but no such protest is necessary in the case of a note.

(g) When a bill is dishonoured, due notice of dishonour is to be given by the holder to the drawer and the intermediate endorsee, but no such notice need to be given in the case of a note.

(h) A bill can be drawn payable to bearer provided it is not payable on demand. A promissory note cannot be made payable to bearer, even if it is made payable otherwise than on demand.

How Bill of Exchange Originates – Forms of Bills of Exchange

Bills of exchange were originally used for payment of debts by traders residing in one country to another country with a view to avoid transmission of coin. Now-a-days they are used more as trade bills both in connection with domestic trade and foreign trade and are called inland bills and foreign bills respectively.

Inland Bills (Sections 11 and 12)

A bill of exchange is an inland instrument if it is (i) drawn or made and payable in India, or (ii) drawn in India upon any person who is a resident in India, even though it is made payable in a foreign country. But a promissory note to be an inland should be drawn and payable in India, as it has no drawee.

Two essential conditions to make an inland instrument are:

(1) the instrument must have been drawn or made in India; and

(2) the instrument must be payable in India or the drawee must be in India.

Examples: A bill drawn in India, payable in USA, upon a person in India is an inland instrument. A bill drawn in India and payable in India but drawn on a person in USA is also an inland instrument.

Foreign Bills

All bills which are not inland are deemed to be foreign bills. Normally foreign bills are drawn in sets of three copies.

Trade Bill

A bill drawn and accepted for a genuine trade transaction is termed as a trade bill. When a trader sells goods on credit, he may make use of a bill of exchange. Suppose A sells goods worth Rs. 1,000 to B and allows him 90 days time to pay the price, A will draw a bill of exchange on B, in the following terms: “Ninety days after date pay A or order, the sum of one thousand rupees only for value received”. A will sign the bill and then present it to B for acceptance. This is necessary because, until a bill is accepted by the drawee, nobody has either rights or obligations. If B agrees to obey the order of A, he will accept the bill by writing across its face the word “accepted” and signing his name underneath and then delivering the bill to the holder. B, the drawee, now becomes the acceptor of the bill and liable to its holders. Such a bill is a genuine trade bill.

Accommodation Bill

All bills are not genuine trade bills, as they are often drawn for accommodating a party. An accommodation bill is a bill in which a person lends or gives his name to oblige a friend or some person whom he knows or otherwise. In other words, a bill which is drawn, accepted or endorsed without consideration is called an accommodation bill. The party lending his name to oblige the other party is known as the accommodating or accommodation party, and the party so obliged is called the party accommodated. An accommodation party is not liable on the instrument to the party accommodated because as between them there was no consideration and the instrument was merely to help. But the accommodation party is liable to a holder for value, who takes the accommodation bill for value, though such holder may not be a holder in due course. Thus, A may be in need of money and approach his friends B and C who, instead of lending the money directly, propose to draw an "Accommodation Bill" in his favour in the following form:

> "Three months after date pay A or order, the sum of Rupees one thousand only".
>
> B.
>
> To
>
> C.

If the credit of B and C is good, this device enables A to get an advance of Rs. 1,000 from his banker at the commercial rate of discount. The real debtor in this case is not C, but A the payee who promises to reimburse C before the period of three months only. A is here the principal debtor and B and C are mere sureties. This inversion of liability affords a good definition of an accommodation bill: "If as between the original parties to the bill the one who should prima facie be principal is in fact the surety whether he be drawer, acceptor, or endorser, that bill is an accommodation bill".

Bills in Sets (Section 132 and 133)

Foreign bills are usually drawn in sets to avoid the danger of loss. They are drawn in sets of three, each of which is called "Via" and as soon as any one of them is paid, the others become inoperative. All these parts form one bill and the drawer must sign and deliver all of them to the payee. The stamp is affixed only on one part and one part is required to be accepted. But if the drawer mistakenly accepts all the parts of the same bill, he will be liable on each part accepted as if it were a separate bill.

Right to Duplicate Bill

Where a bill of exchange has been lost before it was overdue, the person who was the holder to it may apply to the drawer, to give him another bill of the same tenor. It is only the holder who can ask for a duplicate bill, promissory note or cheque.

Bank Draft

A bill of exchange is also sometimes spoken of as a draft. It is called as a bank draft when a bill of exchange drawn by one bank on another bank, or by itself on its own branch, and is a negotiable instrument. It is very much like the cheque with three points of distinction between the two. A bank draft can be drawn only by a bank on another bank, usually its own branch. It cannot so easily be counter-manded. It cannot be made payable to bearer.

Specimen of a Bank Draft

A.B.C. Bank

X.Y.Z. Branch

No. .... Date ....

On demand pay 'A' or order the sum of rupees one thousand five hundred only for value received.

Rs. 1,500/-

Sd./-

Manager

To

'B' Branch, (Place)

In the above demand draft the drawer is X.Y.Z. Branch, the drawee is 'B' branch and the payee is 'A'.

(iii) Cheque

The Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 has broadened, the definition of cheque to include the electronic image of a truncated cheque and a cheque in the electronic form. Section 6***** of the Act provides that a 'cheque' is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.******

Despite the amendment as is evident the basic definition of the cheque has been retained and the definition has only been enlarged to include cheques in the above form as well.

As per explanation appended to the section, the expression:

(a) 'a cheque in the electronic form' means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system;

(b) 'a truncated cheque' means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing. (Explanation I).

The expression 'clearing house' means the clearing house managed by the Reserve Bank of India or a clearing house recognised as such by the Reserve Bank of India. (Explanation II).

Simply stated, a cheque is a bill of exchange drawn on a bank payable always on demand. Thus, a cheque is a bill of exchange with two additional qualifications, namely: (i) it is always drawn on a banker, and (ii) it is always payable on demand. A cheque being a species of a bill of exchange, must satisfy all the requirements of a bill; it does not, however, require acceptance.

Note: By virtue of Section 31 of the Reserve Bank of India Act, no bill of exchange or hundi can be made payable to bearer on demand and no promissory note or a bank draft can be made payable to bearer at all, whether on demand or after a specified time. Only a cheque can be payable to bearer on demand.

Parties to a Cheque

The following are the parties to a cheque:

(a) The drawer: The person who draws the cheque.

(b) The drawee: The banker of the drawer on whom the cheque is drawn.

(c), (d), (e) and (f) The payee, holder, endorser and endorsee: same as in the case of a bill.

Essentials of a Cheque

(1) It is always drawn on a banker.

(2) It is always payable on demand.

(3) It does not require acceptance. There is, however, a custom among banks to mark cheques as good for purposes of clearance.

(4) A cheque can be drawn on bank where the drawer has an account.

(5) Cheques may be payable to the drawer himself. It may be made payable to bearer on demand unlike a bill or a note.

(6) The banker is liable only to the drawer. A holder has no remedy against the banker if a cheque is dishonoured.

(7) A cheque is usually valid for fix months. However, it is not invalid if it is post dated or ante-dated.

(8) No Stamp is required to be affixed on cheques.

Distinction between Cheques and Bills of Exchange

As a general rule, the provisions applicable to bills payable on demand apply to cheques, yet there are few points of distinction between the two, namely:

(a) A cheque is a bill of exchange and always drawn on a banker, while a bill may be drawn on any one, including banker.

(b) A cheque can only be drawn payable on demand, a bill may be drawn payable on demand, or on the expiry of a specified period after sight or date.

(c) A bill payable after sight must be accepted before payment can be demanded, a cheque does not require acceptance and is intended for immediate payment.

(d) A grace of 3 days is allowed in the case of time bills, while no grace is given in the case of a cheque, for payment.

(e) The drawer of a bill is discharged, if it is not presented for payment, but the drawer of a cheque is discharged only if he suffers any damage by delay in presentment for payment.

(f) Notice of the dishonour of a bill is necessary, but not in the case of a cheque.

(g) The cheque being a revocable mandate, the authority may be revoked by countermanding payment, and is determined by notice of the customer's death or insolvency. This is not so in the case of bill.

(h) A cheque may be crossed, but not a bill.

A cheque is a bill of exchange drawn on a specified banker and always payable on demand. A cheque is always drawn on a particular banker and is always payable on demand. Consequently, all cheques are bills of exchange but all bills are not cheques.

Specimen of a Cheque

A.B.C. Bank

X.Y.Z. Branch

Date..................................

Pay 'A' .... or the bearer sum of rupees .... only.

Rs. ..../-

A/c No..............LF............

No....................................   Sd/-

Banker

A banker is one who does banking business. Section 5(b) of the Banking Regulation Act, 1949 defines banking as, "accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft or otherwise." This definition emphasises two points: (1) that the primary function of a banker consists of accepting of deposits for the purpose of lending or investing the same; (2) that the amount deposited is repayable to the depositor on demand or according to the agreement. The demand for repayment can be made through a cheque, draft or otherwise, and not merely by verbal order.

Customer

The term "customer" is neither defined in Indian nor in English statutes. The general opinion is that a customer is one who has an account with the bank or who utilises the services of the bank.

The special features of the legal relationship between the banker and the customer may be termed as the obligations and rights of the banker. These are:

1. Obligation to honour cheques of the customers.
2. Obligation to collect cheques and drafts on behalf of the customers.
3. Obligation to keep proper record of transactions with the customer.
4. Obligation to comply with the express standing instructions of the customer.
5. Obligation not to disclose the state of customer's account to anyone else.
6. Obligation to give reasonable notice to the customer, if the banker wishes to close the account.
7. Right of lien over any goods and securities bailed to him for a general balance of account.
8. Right of set off and right of appropriation.
9. Right to claim incidental charges and interest as per rules and regulations of the bank, as communicated to the customer at the time of opening the account.

Liability of a Banker

By opening a current account of a customer, the banker becomes liable to his debtor to the extent of the amount so received in the said account and undertakes to honour the cheques drawn by the customer so long as he holds sufficient funds to the customer's credit. If a banker, without justification, fails to honour his customer's cheques, he is liable to compensate the drawer for any loss or damage suffered by him. But the payee or holder of the cheque has no cause of action against the banker as the obligation to honour a cheque is only towards the drawer.

The banker must also maintain proper and accurate accounts of credits and debits. He must honour a cheque presented in due course. But in the following circumstances, he must refuse to honour a cheque and in some others he may do so.

When Banker must Refuse Payment

In the following cases the authority of the banker to honour customer's cheque comes to an end, he must refuse to honour cheques issued by the customer:

(a) When a customer countermands payment i.e., where or when a customer, after issuing a cheque issues instructions not to honour it, the banker must not pay it.

(b) When the banker receives notice of customer's death.

(c) When customer has been adjudged an insolvent.

(d) When the banker receives notice of customer's insanity.

(e) When an order (e.g., Garnishee Order) of the Court, prohibits payment.

(f) When the customer has given notice of assignment of the credit balance of his account.

(g) When the holder's title is defective and the banker comes to know of it.

(h) When the customer has given notice for closing his account.

When Banker may Refuse Payment

In the following cases the banker may refuse to pay a customer's cheque:

(a) When the cheque is post-dated.

(b) When the banker has no sufficient funds of the drawer with him and there is no communication between the bank and the customer to honour the cheque.

(c) When the cheque is of doubtful legality.

(d) When the cheque is not duly presented, e.g., it is presented after banking hours.

(e) When the cheque on the face of it is irregular, ambiguous or otherwise materially altered.

(f) When the cheque is presented at a branch where the customer has no account.

(g) When some persons have joint account and the cheque is not signed jointly by all or by the survivors of them.

(h) When the cheque has been allowed to become stale, i.e., it has not been presented within six months of the date mentioned on it.

Protection of Paying Banker (Sections 10, 85 and 128)

Section 85 lays down that where a cheque payable to order purports to be endorsed by or on behalf of the payee the banker is discharged by payment in due course. He can debit the account of the customer with the amount even though the endorsement turns out subsequently to have been forged, or the agent of the payee without authority endorsed it on behalf of the payee. It would be seen that the payee includes endorsee. This protection is granted because a banker cannot be expected to know the signatures of all the persons in the world. He is only bound to know the signatures of his own customers.

Therefore, the forgery of drawer's signature will not ordinarily protect the banker but even in this case, the banker may debit the account of the customer, if it can show that the forgery was intimately connected with the negligence of the customer and was the proximate cause of loss.

In the case of bearer cheques, the rule is that once a bearer cheque, always a bearer cheque. Where, therefore, a cheque originally expressed by the drawer himself to be payable to bearer, the banker may ignore any endorsement on the cheque. He will be discharged by payment in due course. But a cheque which becomes bearer by a subsequent endorsement in blank is not covered by this Section. A banker is discharged from liability on a crossed cheque if he makes payment in due course.

Payment in Due Course (Section 10)

Any person liable to make payment under a negotiable instrument, must make the payment of the amount due thereunder in due course in order to obtain a valid discharge against the holder.

A payment in due course means a payment in accordance with the apparent tenor of the instrument, in good faith and without negligence to any person in possession thereof.

A payment will be a payment in due course if:

(a) it is in accordance with the apparent tenor of the instrument, i.e., according to what appears on the face of the instrument to be the intention of the parties;

(b) it is made in good faith and without negligence, and under circumstances which do not afford a ground for believing that the person to whom it is made is not entitled to receive the amount;

(c) it is made to the person in possession of the instrument who is entitled as holder to receive payment;

(d) payment is made under circumstances which do not afford a reasonable ground believing that he is not entitled to receive payment of the amount mentioned in the instrument; and

(e) payment is made in money and money only.

Under Sections 10 and 128, a paying banker making payment in due course is protected.

Collecting Banker

Collecting Banker is one who collects the proceeds of a cheque for a customer. Although a banker collects the proceeds of a cheque for a customer purely as a matter of service, yet the Negotiable Instruments Act, 1881 indirectly imposes statutory obligation, statutory in nature. This is evident from Section 126 of the Act which provides that a cheque bearing a “general crossing” shall not be paid to anyone other than banker and a cheque which is “specially crossed” shall not be paid to a person other than the banker to whom it is crossed. Thus, a paying banker must pay a generally crossed cheque only to a banker thereby meaning that it should be collected by another banker. While so collecting the cheques for a customer, it is quite possible that the banker collects for a customer, proceeds of a cheque to which the customer had no title in fact. In such cases, the true owner may sue the collecting banker for “conversion”. At the same time, it cannot be expected of a banker to know or to ensure that all the signatures appearing in endorsements on the reverse of the cheque are genuine. The banker is expected to be conversant only with the signatures of his customer. A customer to whom a cheque has been endorsed, would request his banker to collect a cheque. In the event of the endorser’s signature being proved to be forged at later date, the banker who collected the proceeds should not be held liable for the simple reason that he has merely collected the proceeds of a cheque. Section 131 of the Negotiable Instruments Act affords statutory protection in such a case where the customer’s title to the cheque which the banker has collected has been questioned. It reads as follows:

“A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason of only having received such payment.

Explanation: A banker receives payment of a crossed cheque for a customer within the meaning of this section notwithstanding that he credits his customer’s account with the amount of the cheque before receiving payment thereof.”

The Amendment Act, 2002 has added a new explanation to Section 131 which provides that it shall be the duty of the banker who receives payment based on an electronic image of a truncated cheque held with him, to verify the *prima facie* genuineness of the cheque to be truncated and any fraud, forgery or tampering apparent on the face of the instrument that can be verified with due diligence and ordinary care. *(Explanation II)*

The requisites of claiming protection under Section 131 are as follows:

(i) The collecting banker should have acted in good faith and without negligence. An act is done in good faith when it is done honestly. The plea of good faith can be rebutted on the ground of recklessness indicative of want of proper care and attention. Therefore, much depends upon the facts of the case. The burden of proving that the cheque was collected in good faith and without negligence is upon the banker claiming protection. Failure to verify the regularity of endorsements, collecting a cheque payable to the account of the company to the credit of the director, etc. are examples of negligence.

(ii) The banker should have collected a crossed cheque, i.e., the cheque should have been crossed before it came to him for collection.

(iii) The proceeds should have been collected for a customer, i.e., a person who has an account with him.

(iv) That the collecting banker has only acted as an agent of the customer. If he had become the holder for value, the protection available under Section 131 is forfeited—Where for instance, the banker allows the customer to withdraw the amount of the cheque before the cheque is collected or where the cheque has been accepted in specific reduction of an overdraft, the banker is *deemed to have become the holder for value and the protection is lost*. But the explanation to Section 131 says that the mere crediting of the amount to the account does not imply that the banker has become a holder for value because due to accounting conveniences the banker may credit the account of the cheque to the customer's account even before proceeds thereof are realised.

Overdue, Stale or Out-of-date Cheques

A cheque is overdue or becomes statute-barred after three years from its due date of issue. A holder cannot sue on the cheque after that time. Apart from this provision, the holder of a cheque is required to present it for payment within a reasonable time, as a cheque is not meant for indefinite circulation. In India, a cheque, which has been in circulation for more than six months, is regarded by bankers as stale. If, as a result of any delay in presenting a cheque, the drawer suffers any loss, as by the failure of the bank, the drawer is discharged from liability to the holder to the extent of the damage.

Liability of Endorser

In order to charge an endorser, it is necessary to present the cheque for payment within a reasonable time of its delivery by such endorser. 'A' endorses and delivers a cheque to B, and B keeps it for an unreasonable length of time, and then endorses and delivers it to C. C presents it for payment within a reasonable time after its receipt by him, and it is dishonoured. C can enforce payment against B but not against A, as *qua* A, the cheque has become stale.

Rights of Holder against Banker

A banker is liable to his customer for wrongful dishonour of his cheque but it is not liable to the payee or holder of the cheque. The holder has no right to enforce payment from the banker except in two cases, namely, (i) where the holder does not present the cheque within a reasonable time after issue, and as a result the drawer suffers damage by the failure of the banker in liquidation proceedings; and (ii) where a banker pays a crossed cheque by mistake over the counter, he is liable to the owner for any loss occasioned by it.

Crossing of Cheques

A cheque is either "open" or "crossed". An open cheque can be presented by the payee to the paying banker and is paid over the counter. A crossed cheque cannot be paid across the counter but must be collected through a banker.

A crossing is a direction to the paying banker to pay the money generally to a banker or to a particular banker, and not to pay otherwise. The object of crossing is to secure payment to a banker so that it could be traced to the person receiving the amount of the cheque. Crossing is a direction to the paying banker that the cheque should be paid only to a banker or a specified banker. To restrain negotiability, addition of words "Not Negotiable" or "Account Payee Only" is necessary. A crossed bearer cheque can be negotiated by delivery and crossed order cheque by endorsement and delivery. Crossing affords security and protection to the holder of the cheque.

Modes of Crossing (Sections 123-131A)

There are two types of crossing which may be used on cheque, namely: (i) General, and (ii) Special. To these may be added another type, i.e. Restrictive crossing.

It is general crossing where a cheque bears across its face an addition of two parallel transverse lines and/or the addition of the words "and Co." between them, or addition of "not negotiable". As stated earlier, where a cheque is crossed generally, the paying banker will pay to any banker. Two transverse parallel lines are essential for a general crossing (Sections 123-126).

In case of general crossing, the holder or payee cannot get the payment over the counter of the bank but through a bank only. The addition of the words "and Co." do not have any significance but the addition of the words "not negotiable" restrict the negotiability of the cheque and in case of transfer, the transferee will not give a better title than that of a transferor.

Where a cheque bears across its face an addition of the name of a banker, either with or without the words "not negotiable" that addition constitutes a crossing and the cheque is crossed specially and to that banker. The paying banker will pay only to the banker whose name appears across the cheque, or to his collecting agent. Parallel transverse lines are not essential but the name of the banker is the insignia of a special crossing.

In case of special crossing, the paying banker is to honour the cheque only when it is prescribed through the bank mentioned in the crossing or it's agent bank.

Account Payee's Crossing: Such crossing does, in practice, restrict negotiability of a cheque. It warns the collecting banker that the proceeds are to be credited only to the account of the payee, or the party named, or his agent. If the collecting banker allows the proceeds of a cheque bearing such crossing to be credited to any other account, he will be guilty of negligence and will not be entitled to the protection given to collecting banker under Section 131. Such crossing does not affect the paying banker, who is under no duty to ascertain that the cheque is in fact collected for the account of the person named as payee.

Not Negotiable Crossing

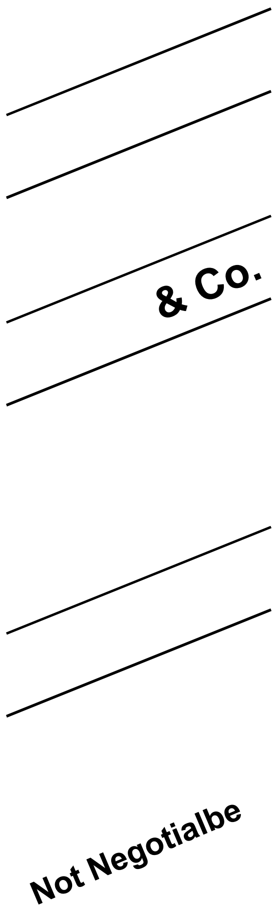
A cheque may be crossed not negotiable by writing across the face of the cheque the words "Not Negotiable" within two transverse parallel lines in the case of a general crossing or alongwith the name of a banker in the case of a special crossing. Section 130 of the Negotiable Instruments Act provides "A person taking a cheque crossed generally or specially bearing in either case with the words "not negotiable" shall not have and shall not be capable of giving, a better title to the cheque than that which the person from whom he took it had". The crossing of cheque "not negotiable" does not mean that it is non-transferable. It only deprives the instrument of the incident of negotiability. Normally speaking, the essential feature of a negotiable instrument as opposed to chattels is that a person who takes the instrument in good faith, without negligence, for value, before maturity and without knowledge of the defect in the title of the transferor, gets a good title to the instrument. In other words, he is called a holder in due course who acquires an indisputable title to the cheque. (When the instrument passes through a holder-in-due course, it is purged of all defects and the subsequent holders also get good title). It is exactly this important feature which is taken away by crossing the cheque "not negotiable". In other words, a cheque crossed "not negotiable" is like any other chattel and therefore the transferee gets same title to the cheque which his transferor had. That is to say that the transferee cannot claim the rights of a holder-in-due-course. So long as the title of the transferors is good, the title of the transferees is also good but if there is a taint in the title to the cheque of one of the endorsers, then all the subsequent transferees' title also become tainted with the same defectthey cannot claim to be holders-in-due-course.

The object of this Section is to afford protection to the drawer or holder of a cheque who is desirous of transmitting it to another person, as much protection as can reasonably be afforded to him against dishonestly or actual miscarriage in the course of transit. For example, a cheque payable to bearer is crossed generally and is marked "not negotiable". It is lost or stolen and comes into the possession of X who takes it in good faith and gives value for it, X collects the cheque through his bank and paying banker also pays. In this case, both the paying and the collecting bankers are protected under Sections 128 and 131 respectively. But X cannot claim that he is a holder-in-due course which he could have under the normal circumstances claimed. The reason is that cheque is crossed "not negotiable" and hence the true owner's (holder's) right supercedes the rights of the holder-in-due-course. Since X obtained the cheque from a person who had no title to the cheque (i.e. from one whose title was defective) X can claim no better title solely because the cheque was crossed "not negotiable" and not for any other reason. Thus "not negotiable" crossing not only protects the rights of the true owner of the cheque but also serves as a warning to the endorsees' to enquire thoroughly before taking the cheque as they may have to be answerable to the true owner thereof if the endorser's title is found to be defective.

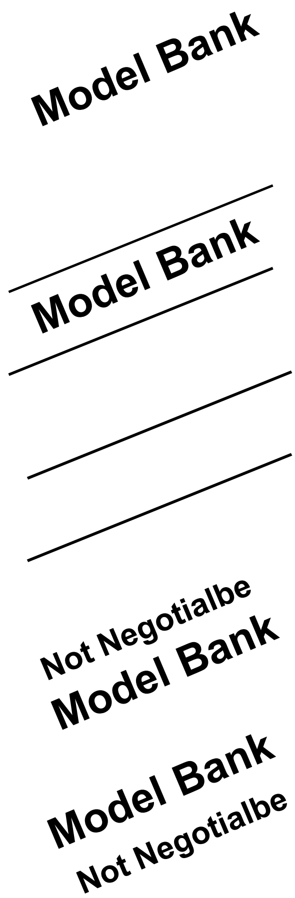
"Not negotiable" restricts the negotiability of the cheque and in case of transfer, the transferee will not get a better title than that of a transferor.

If the cheque becomes "not negotiable" it lacks negotiability. A cheque crossed specially or generally bearing the words "not negotiable", lacks negotiability and therefore is not a negotiable instrument in the true sense. It does not restrict transferability but restricts negotiability only.

Specimen of a general crossing



Specimen of a special crossing



Maturity

Cheques are always payable on demand but other instruments like bills, notes, etc. may be made payable on a specified date or after the specified period of time. The date on which payment of an instrument falls due is called its maturity. According to Section 22 of the Act, "the maturity of a promissory note or a bill of exchange is the date at which it falls due". According to Section 21 a promissory note or bill of exchange payable "at sight" or "on presentment" is payable on demand. It is due for payment as soon as it is issued. The question of maturity, therefore, arises only in the case of a promissory note or a bill of exchange payable "after date" or "after sight" or at a certain period after the happening of an event which is certain to happen.

Maturity is the date on which the payment of an instrument falls due. Every instrument payable at a specified period after date or after sight is entitled to three days of grace. Such a bill or note matures or falls due on the last day of the grace period, and must be presented for payment on that day and if dishonoured, suit can be instituted on the next day after maturity. If an instrument is payable by instalments, each instalment is entitled to three days of grace. No days of grace are allowed for cheques, as they are payable on demand.

Where a note or bill is expressed to be payable on the expiry of specified number of months after sight, or after date, the period of payment terminates on the day of the month which corresponds with the date of instrument, or with the date of acceptance if the bill be accepted or presented for sight, or noted or protested for non-acceptance. If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.

Illustrations

(i) A negotiable instrument dated 31st January, 2001, is made payable at one months after date. The instrument is at maturity on the third day after the 28th February, 2001, i.e. on 3rd March, 2001.

(ii) A negotiable instrument dated 30th August, 2001, is made payable three months after date. The instrument is at maturity on 3rd December, 2001.

(iii) A negotiable instrument dated the 31st August, 2001, is made payable three months after date. The instrument is at maturity on 3rd December, 2001.

If the day of maturity falls on a public holiday, the instrument is payable on the preceeding business day. Thus, if a bill is at maturity on a Sunday. It will be deemed due on Saturday and not on Monday.

The ascertainment of the date of maturity becomes important because all these instruments must be presented for payment on the last day of grace and their payment cannot be demanded before that date. Where an instrument is payable by instalments, it must be presented for payment on the third day after the day fixed for the payment of each instalment.

Holder

According to Section 8 of the Act a person is a holder of a negotiable instrument who is entitled in his own name (i) to the possession of the instrument, and (ii) to recover or receive its amount from the parties thereto. It is not every person in possession of the instrument who is called a holder. To be a holder, the person must be named in the instrument as the payee, or the endorsee, or he must be the bearer thereof. A person who has obtained possession of an instrument by theft, or under a forged endorsement, is not a holder, as he is not entitled to recover the instrument. The holder implies de jure (holder in law) holder and not de facto (holder in fact) holder. An agent holding an instrument for his principal is not a holder although he may receive its payment.

Holder in Due Course

Section 9 states that a holder in due course is (i) a person who for consideration, obtains possession of a negotiable instrument if payable to bearer, or (ii) the payee or endorsee thereof, if payable to order, before its maturity and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

In order to be a holder in due course, a person must satisfy the following conditions:

(i) He must be the holder of the instrument.

(ii) He should have obtained the instrument for value or consideration.

(iii) He must have obtained the negotiable instrument before maturity.

(iv) The instrument should be complete and regular on the face of it.

(v) The holder should take the instrument in good faith.

A holder in due course is in a privileged position. He is not only himself protected against all defects of the persons from whom he received the instrument as current coin, but also serves as a channel to protect all subsequent holders. A holder in due course can recover the amount of the instrument from all previous parties, although, as a matter of fact, no consideration was paid by some of the previous parties to the instrument or there was a defect of title in the party from whom he took it. Once an instrument passes through the hands of a holder in due course, it is purged of all defects. It is like current coin. Whoever takes it can recover the amount from all parties previous to such holder.

Capacity of Parties

Capacity to incur liability as a party to a negotiable instrument is co-extensive with capacity to contract. According to Section 26, every person capable of contracting according to law to which he is subject, may bind himself and be bound by making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

Negatively, minors, lunatics, idiots, drunken person and persons otherwise disqualified by their personal law, do not incur any liability as parties to negotiable instruments. But incapacity of one or more of the parties to a negotiable instrument in no way, diminishes the abilities and the liabilities of the competent parties. Where a minor is the endorser or payee of an instrument which has been endorsed all the parties accepting the minor are liable in the event of its dishonour.

Liability of Parties

The provisions regarding the liability of parties to negotiable instruments are laid down in Sections 30 to 32 and 35 to 42 of the Negotiable Instruments Act. These provisions are as follows:

1. Liability of Drawer (Section 30)

The drawer of a bill of exchange or cheque is bound, in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been given to or received by the drawer.

The nature of drawer's liability is that by drawing a bill, he undertakes that (i) on due presentation, it shall be accepted and paid according to its tenor, and (ii) in case of dishonour, he will compensate the holder or any endorser, provided notice of dishonour has been duly given. However, in case of accommodation bill no notice of dishonour to the drawer is required.

The liability of a drawer of a bill of exchange is secondary and arises only on default of the drawee, who is primarily liable to make payment of the negotiable instrument.

2. Liability of the Drawee of Cheque (Section 31)

The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required to do so and, or in default of such payment, he shall compensate the drawer for any loss or damage caused by such default.

As a cheque is a bill of exchange, drawn on a specified banker, the drawee of a cheque must always be a banker. The banker, therefore, is bound to pay the cheque of the drawer, i.e., customer, if the following conditions are satisfied:

(i) The banker has sufficient funds to the credit of customer's account.

(ii) The funds are properly applicable to the payment of such cheque, e.g., the funds are not under any kind of lien etc.

(iii) The cheque is duly required to be paid, during banking hours and on or after the date on which it is made payable.

If the banker is unjustified in refusing to honour the cheque of its customer, it shall be liable for damages.

3. Liability of "Maker" of Note and "Acceptor" of Bill (Section 32)

In the absence of a contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity, according to the apparent tenor of the note or acceptance respectively. The acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand.

It follows that the liability of the acceptor of a bill corresponds to that of the maker of a note and is absolute and unconditional but the liability under this Section is subject to a contract to the contrary (e.g., as in the case of accommodation bills) and may be excluded or modified by a collateral agreement. Further, the payment must be made to the party named in the instrument and not to any-one else, and it must be made at maturity and not before.

4. Liability of Endorser (Section 35)

Every endorser incurs liability to the parties that are subsequent to him. Whoever endorses and delivers a negotiable instrument before maturity is bound thereby to every subsequent holder in case of dishonour of the instrument by the drawee, acceptor or maker, to compensate such holder of any loss or damage caused to him by such dishonour provided (i) there is no contract to the contrary; (ii) he (endorser) has not expressly excluded, limited or made conditional his own liability; and (iii) due notice of dishonour has been given to, or received by, such endorser. Every endorser after dishonour, is liable upon the instrument as if it is payable on demand.

He is bound by his endorsement notwithstanding any previous alteration of the instrument. (Section 88)

5. Liability of Prior Parties (Section 36)

Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied. Prior parties may include the maker or drawer, the acceptor and all the intervening endorsers to a negotiable instrument. The liability of the prior parties to a holder in due course is joint and several. The holder in due course may hold any or all prior parties liable for the amount of the dishonoured instrument.

6. Liability Inter se

Various parties to a negotiable instrument who are liable thereon stand on a different footing with respect to the nature of liability of each one of them.

7. Liability of Acceptor of Forged Endorsement (Section 41)

An acceptor of a bill of exchange already endorsed is not relieved from liability by reason that such endorsement is forged, if he knew or had reason to believe the endorsement to be forged when he accepted the bill.

8. Acceptor's Liability on a Bill drawn in a Fictitious Name

An acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due course claiming under an endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer.

REVIEW QUESTION

Fill in the Blanks:

1. .... is an instrument in writing containing an unconditional undertaking signed by the maker to pay a certain sum of money only to, or to the order of a certain person, or to the bearer.

2. .... is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer.

3. .... is a person entitled in his own name to the possession of a promissory note, bill of exchange or cheque and to receive or recover the amount due thereon from the parties.

4. .... is generally a person who for consideration became possessor of a promissory note, bill of exchange or cheque.

5. Negotiable Instrument is defined in ....

6. Cheque is always drawn on bank and it includes .... and .... cheque.

7. Liability of drawer to compensate the holder in case of dishonour is primarily provided under ....

8. A negotiable instrument made, drawn, accepted, endorsed or transferred without consideration, or for a consideration which fails, creates .... of payment between the parties to the transaction.

Answers: 1. Promissory Note 2. Bill of Exchange 3. Holder 4. Holder in due course 5. Section 13(1) 6. Truncated and elctronic 7. Section 30 8. Liability

Negotiation (Section 14)

A negotiable instrument may be transferred by negotiation or assignment. Negotiation is the transfer of an instrument (a note, bill or cheque) for one person to another in such a manner as to convey title and to constitute the transferee the holder thereof*. When a negotiable instrument is transferred by negotiation, the rights of the transferee may rise higher than those of the transferor, depending upon the circumstances

* Section 14 reads "When a promissory note, bill of exchange or cheque is transferred to any person, so as to constitute that person the holder thereof, the instrument is said to be negotiable".

attending the negotiation. When the transfer is made by assignment, the assignee has only those rights which the assignor possessed. In case of assignment, there is a transfer of ownership by means of a written and registered document.

Negotiability and Assignability Distinguished

A transfer by negotiation differs from transfer by assignment in the following respects:

(a) Negotiation requires mere delivery of a bearer instrument and endorsement and delivery of an order instrument to effectuate a transfer. Assignment requires a written document signed by the transferor.

(b) Notice of transfer of debt (actionable claim) must be given by the assignee to the debtor in order to complete his title; no such notice is necessary in a transfer by negotiation.

(c) On assignment, the transferee of an actionable claim takes it subject to all the defects in the title of, and subject to all the equities and defences available against the assignor, even though he took the assignment for value and in good faith. In case of negotiation the transferee, as holder-in-due course, takes the instrument free from any defects in the title of the transferor.

Importance of Delivery

Negotiation is effected by mere delivery of a bearer instrument and by endorsement and delivery of an order instrument. This shows that "delivery" is essential in negotiable instruments. Section 46 expressly provides that making acceptance or endorsement of negotiable instrument is not complete until delivery, actual or constructive, of the instrument. Delivery made voluntarily with the intention of passing property in the instrument to the person to whom it is given is essential.

Negotiation by Mere Delivery

A bill or cheque payable to bearer is negotiated by mere delivery of the instrument. An instrument is payable to bearer:

(i) Where it is made so payable, or

(ii) Where it is originally made payable to order but the only or the last endorsement is in blank.

(iii) Where the payee is a fictitious or a non-existing person.

These instruments do not require signature of the transferor. The person who takes them is a holder, and can sue in his own name on them. Where a bearer negotiates an instrument by mere delivery, and does not put his signature thereon, he is not liable to any party to the instrument in case the instrument is dishonoured, as he has not lent his credit to it. His obligations are only towards his immediate transferee and to no other holders.

A cheque, originally drawn payable to bearer remains bearer, even though it is subsequently endorsed in full. The rule is once a bearer cheque always a bearer cheque.

Negotiation by Endorsement and Delivery

An instrument payable to a specified person or to the order of a specified person or to a specified person or order is an instrument payable to order. Such an instrument can be negotiated only by endorsement and delivery. Unless the holder signs his endorsement on the instrument, the transferee does not become a holder. Where an instrument payable to order is delivered without endorsement, it is merely assigned and not negotiated and the holder thereof is not entitled to the rights of a holder in due course, and he cannot negotiate it to a third person.

Endorsement (Sections 15 and 16)

Where the maker or holder of a negotiable instrument signs the same otherwise than as such maker for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto (called Allonge), or so, signs for the same purpose, a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same (Section 15), the person to whom the instrument is endorsed is called the endorsee.

In other words, 'endorsement' means and involves the writing of something on the back of an instrument for the purpose of transferring the right, title and interest therein to some other person.

Classes of Endorsement

An endorsement may be (a) Blank or General, (b) Special or Full, (c) Restrictive, or (d) Partial, and (e) Conditional or Qualified.

(a) *Blank or General:* An endorsement is to be blank or general where the endorser merely writes his signature on the back of the instrument, and the instrument so endorsed becomes payable to bearer, even though originally it was payable to order. Thus, where bill is payable to "Mohan or order", and he writes on its back "Mohan", it is an endorsement in blank by Mohan and the property in the bill can pass by mere delivery, as long as the endorsement continues to be a blank. But a holder of an instrument endorsed in blank may convert the endorsement in blank into an endorsement in full, by writing above the endorser's signature, a direction to pay the instrument to another person or his order.

(b) *Special or Full:* If the endorser signs his name and adds a direction to pay the amount mentioned in the instrument to, or to the order of a specified person, the endorsement is said to be special or in full. A bill made payable to Mohan or Mohan or order, and endorsed "pay to the order of Sohan" would be specially endorsed and Sohan endorses it further. A blank endorsement can be turned into a special one by the addition of an order making the bill payable to the transferee.

(c) *Restrictive:* An endorsement is restrictive which prohibits or restricts the further negotiation of an instrument. Examples of restrictive endorsement: "Pay A only" or "Pay A for my use" or "Pay A on account of B" or "Pay A or order for collection".

(d) *Partial:* An endorsement partial is one which purports to transfer to the endorsee a part only of the amount payable on the instrument. A partial endorsement does not operate as negotiation of the instrument. A holds a bill for Rs. 1,000 and endorses it as "Pay B or order Rs. 500". The endorsement is partial and invalid.

(e) *Conditional or Qualified:* An endorsement is conditional or qualified which limits or negatives the liability of the endorser. An endorser may limit his liability in any of the following ways:

    (i) By sans recourse endorsement, i.e. by making it clear that he does not incur the liability of an endorser to the endorsee or subsequent holders and they should not look to him in case of dishonour of instrument. The endorser excludes his liability by adding the words "sans recourse" or "without recourse", e.g., "pay A or order sans recourse".

    (ii) By making his liability depending upon happening of a specified event which may never happen, e.g., the holder of a bill may endorse it thus: "Pay A or order on his marrying B". In such a case, the endorser will not be liable until A marries B.

It is pertinent to refer to Section 52 of the Negotiable Instruments Act, 1881 here. It reads "The endorser of a negotiable instrument may, by express words in the endorsement exclude his own liability thereon, or make such liability or the right of the endorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen".

Negotiation Back

Where an endorser negotiates an instrument and again becomes its holder, the instrument is said to be negotiated back to that endorser and none of the intermediary endorsees are then liable to him. The rule prevents a circuity of action. For example, A, the holder of a bill endorses it to B, B endorses to C, and C to D, and endorses it again to A. A, being a holder in due course of the bill by second endorsement by D, can recover the amount thereof from B, C, or D and himself being a prior party is liable to all of them. Therefore, A having been relegated by the second endorsement to his original position, cannot sue B, C and D.

Where an endorser so excludes his liability and afterwards becomes the holder of the instrument, all the intermediate endorsers are liable to him. "the italicised portion of the above Section is important". An illustration will make the point clear. A is the payee of a negotiable instrument. He endorses the instrument 'sans recourse' to B, B endorses to C, C to D, and D again endorses it to A. In this case, A is not only reinstated in his former rights but has the right of an endorsee against B, C and D.

Negotiation of Lost Instrument or that Obtained by Unlawful Means

When a negotiable instrument has been lost or has been obtained from any maker, acceptor or holder thereof by means of an offence or fraud, or for an unlawful consideration, no possessor or endorsee, who claims through the person who found or obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor, or holder from any party prior to such holder unless such possessor or endorsee is, or some person through whom he claims was, a holder in due course.

Forged Endorsement

The case of a forged endorsement is worth special notice. If an instrument is endorsed in full, it cannot be negotiated except by an endorsement signed by the person to whom or to whose order the instrument is payable, for the endorsee obtains title only through his endorsement. Thus, if an instrument be negotiated by means of a forged endorsement, the endorsee acquires no title even though he be a purchaser for value and in good faith, for the endorsement is a nullity. Forgery conveys no title. *But where the instrument is a bearer instrument or has been endorsed in blank, it can be negotiated by mere delivery, and the holder derives his title independent of the forged endorsement and can claim the amount from any of the parties to the instrument.* For example, a bill is endorsed, "Pay A or order". A endorses it in blank, and it comes into the hands of B, who simply delivers it to C, C forges B's endorsement and transfer it to D. Here, D, as the holder does not derive his title through the forged endorsement of B, but through the genuine endorsement of A and can claim payment from any of the parties to the instrument in spite of the intervening forged endorsement.

Acceptance of a Bill of Exchange

The drawee of a bill of exchange, as such, has no liability on any bill addressed to him for acceptance or payment. A refusal to accept or to pay such bill gives the holder no rights against him. The drawee becomes liable only after he accepts the bill. The acceptor has to write the word 'accepted' on the bill and sign his name below it. Thus, it is the acceptor who is primarily liable on a bill.

The acceptance of a bill is the indication by the drawee of his assent to the order of the drawer. Thus, when the drawee writes across the face of the bill the word "accepted" and signs his name underneath he becomes the acceptor of the bill.

An acceptance may be either general or qualified. A general acceptance is absolute and as a rule, an acceptance has to be general. Where an acceptance is made subject to some condition or qualification, thereby varying the effect of the bill, it is a qualified acceptance. The holder of the bill may either refuse to take a qualified acceptance or non-acquiescence in it. Where he refuses to take it, he can treat the bill as dishonoured by non-acceptance, and sue the drawer accordingly.

Acceptance for Honour

When a bill has been noted or protested for non-acceptance or for better security, any person not being a party already liable thereon may, with the consent of the holder, by writing on the bill, accept the same for the honour of any party thereto. The stranger so accepting, will declare under his hand that he accepts the protested bill for the honour of the drawer or any particular endorser whom he names.

The acceptor for honour is liable to pay only when the bill has been duly presented at maturity to the drawee for payment and the drawee has refused to pay and the bill has been noted and protested for non-payment. Where a bill has been protested for non-payment after having been duly accepted, any person may intervene and pay it supra protest for the honour of any party liable on the bill. When a bill is paid *supra protest,* it ceases to be negotiable. The stranger, on paying for honour, acquires all the right of holder for whom he pays.

Presentment for Acceptance

It is only bills of exchange that require presentment for acceptance and even these of certain kinds only. Bills payable on demand or on a fixed date need not be presented. Thus, a bill payable 60 days after due date on the happening of a certain event may or may not be presented for acceptance. But the following bills must be presented for acceptance otherwise, the parties to the bill will not be liable on it:

(a) A bill payable *after sight*. Presentment is necessary in order to fix maturity of the bills; and

(b) A bill in which there is an express stipulation that it shall be presented for acceptance before it is presented for payment.

Section 15 provides that the presentment for acceptance must be made to the drawee or his duly authorised agent. If the drawee is dead, the bill should be presented to his legal representative, or if he has been declared an insolvent, to the official receiver or assigner.

The following are the persons to whom a bill of exchange should be presented:

(i) The drawee or his duly authorised agent.

(ii) If there are many drawees, bill must be presented to all of them.

(iii) The legal representatives of the drawee if drawee is dead.

(iv) The official receiver or assignee of insolvent drawee.

(v) To a drawee in case of need, if there is any. This is necessary when the original drawee refuses to accept the bill.

(vi) The acceptor for honour. In case the bill is not accepted and is noted or protested for non-acceptance, the bill may be accepted by the acceptor for honour. He is a person who comes forward to accept the bill when it is dishonoured by non-acceptance.

The presentment must be made before maturity, within a reasonable time after it is drawn, or within the stipulated period, if any, on a business day within business hours and at the place of business or residence of the drawee. The presentment must be made by exhibiting the bill to the drawee; mere notice of its existence in the possession of holder will not be sufficient.

When presentment is compulsory and the holder fails to present for acceptance, the drawer and all the endorsers are discharged from liability to him.

Presentment for Acceptance when Excused

Compulsory presentment for acceptance is excused and the bill may be treated as dishonoured in the following cases:

(a) Where the drawee cannot be found after reasonable search.

(b) Where drawee is a fictitious person or one incapable of contracting.

(c) Where although the presentment is irregular, acceptance has been refused on some other ground.

Presentment for Payment

Section 64 lays down the general rule as to presentment of negotiable instruments for payment. It says all notes, bills and cheques must be presented for payment thereof respectively by or on behalf of the holder during the usual hours of business and of the maker or acceptor, and if at banker's within banking hours. [Section 64(1)]

As mentioned earlier, the definition of cheque has been broadened to include the electronic image of a truncated cheque and a cheque in the electronic form. Thus, the section has also been suitably amended to provide rules as to presentment of truncated cheque. The amendment, despite recognising electronic image of a truncated cheque, has made provision for the drawee bank to call for the truncated cheque in original if it is not satisfied about the instrument.

Section 64(2)***** stipulates, where an electronic image of a truncated cheque is presented for payment, the drawee bank is entitled to demand any further information regarding the truncated cheque from the bank holding the truncated cheque in case of any reasonable suspicion about the genuineness of the apparent tenor of instrument, and if the suspicion is that of any fraud, forgery, tampering or destruction of the instrument, it is entitled to further demand the presentment of the truncated cheque itself for verification:

Provided that the truncated cheque so demanded by the drawee bank shall be retained by it, if the payment is made accordingly.

Presentment for Payment when Excused

No presentment is necessary and the instrument may be treated as dishonoured in the following cases:

(a) Where the maker, drawer or acceptor actively does something so as to intentionally obstruct the presentment of the instrument, e.g., deprives the holder of the instrument and keeps it after maturity.

(b) Where his business place is closed on the due date.

(c) Where no person is present to make payment at the place specified for payment.

(d) Where he cannot, after due search be found. (Section 61)

(e) Where there is a promise to pay notwithstanding non-presentment.

(f) Where the presentment is express or impliedly waived by the party entitled to presentment.

(g) Where the drawer could not possibly have suffered any damage by non-presentment.

(h) Where the drawer is a fictitious person, or one incompetent to contract.

(i) Where the drawer and the drawee are the same person.

(j) Where the bill is dishonoured by non-acceptance.

(k) Where presentment has become impossible, e.g., the declaration of war between the countries of the holder and drawee.

(l) Where though the presentment is irregular, acceptance has been refused on some other grounds.

Dishonour by Non-Acceptance

Section 91 provides that a bill is said to be dishonoured by non-acceptance:

(a) When the drawee does not accept it within 48 hours from the time of presentment for acceptance.

(b) When presentment for acceptance is excused and the bill remains unaccepted.

(c) When the drawee is incompetent to contract.

(d) When the drawee is a fictitious person or after reasonable search can not be found.

(e) Where the acceptance is a qualified one.

Dishonour by Non-Payment (Section 92)

A promissory note, bill of exchange or cheque is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same. Also, a negotiable instrument is dishonoured by non-payment when presentment for payment is excused and the instrument when overdue remains unpaid.

If the bill is dishonoured either by non-acceptance or by non-payment, the drawer and all the endorsers of the bill are liable to the holder, provided he gives notice of such dishonour. The drawee is liable only when there is dishonour by non-payment.

Notice of Dishonour (Sections 91-98 and Sections 105-107)

When a negotiable instrument is dishonoured either by non-acceptance or by non-payment, the holder or some party liable thereon must give notice of dishonour to all other parties whom he seeks to make liable. Each party receiving notice of dishonour must in order to render any prior party liable to himself, give notice of dishonour to such party within a reasonable time after he has received it. The object of giving notice is not to demand payment but to whom the party notified of his liability and in case of drawer to enable him to protect himself as against the drawee or acceptor who has dishonoured the instrument issued by him. Notice of dishonour is so necessary that an omission to give it discharges all parties other than the maker or acceptor. These parties are discharged not only on the bill or note, but also in respect of the original consideration.

Notice may be oral or in writing, but it must be actual formal notice. It must be given within a responsible time of dishonour.

Notice of Dishonour Unnecessary

No notice of dishonour is necessary:

(a) When it is dispensed with or waived by the party entitled thereto, e.g., where an endorser writes on the instrument such words as “notice of dishonour waived”,

(b) When the drawer has countermanded payment.

(c) When the party charged would not suffer damage for want of notice.

(d) When the party entitled to notice cannot after due search be found.

(e) When the omission to give notice is caused by unavoidable circumstances, e.g., death or dangerous illness of the holder.

(f) Where the acceptor is also a drawer, e.g., where a firm draws on its branch.

(g) Where the promissory note is not negotiable. Such a note cannot be endorsed.

(h) Where the party entitled to notice promises to pay unconditionally.

Noting and Protest (Sections 99-104 A)

Noting

Where a note or bill is dishonoured, the holder is entitled after giving due notice of dishonour, to sue the drawer and the endorsers. Section 99 provides a convenient method of authenticating the fact of dishonour by means of "Noting". Where a bill or note is dishonoured, the holder may, if he so desires, cause such dishonour to be noted by a notary public on the instrument, or on a paper attached thereto or partly on each. The noting or minute must be recorded by the notary public within a reasonable time after dishonour and must contain the fact of dishonour, the date of dishonour, the reason, if any, assigned for such dishonour if the instrument has not been expressly dishonoured the reasons why the holder treats it dishonoured and notary's charges.

Protest

The protest is the formal notarial certificate attesting the dishonour of the bill, and based upon the noting which has been effected on the dishonour of the bill. After the noting has been made, the formal protest is drawn up by the notary and when it is drawn up it relates back to the date of noting.

Where the acceptor of a bill has become insolvent, or has suspended payment, or his credit has been publicly impeached, before the maturity of the bill, the holder may have the bill protested for better security. The notary public demands better security and on its refusal makes a protest known as "protest for better security".

Foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn. Foreign promissory notes need not be so protested. Where a bill is required by law to be protested, then instead of a notice of dishonour, notice of protest must be given by the notary public.

A protest to be valid must contain on the instrument itself or a literal transcript thereof, the names of the parties for and against whom protest is made, the fact and reasons for dishonour together with the place and time of dishonour and the signature of the notary public. Protest affords an authentic evidence of dishonour to the drawer and the endorsee.

Discharge

The discharge in relation to negotiable instrument may be either (i) discharge of the instrument or (ii) discharge of one or more parties to the instrument from liability.

Discharge of the Instrument

A negotiable instrument is discharged:

(a) by payment in due course;

(b) when the principal debtor becomes the holder;

(c) by an act that would discharge simple contract;

(d) by renunciation; and

(e) by cancellation.

Discharge of a Party or Parties

When any particular party or parties are discharged, the instrument continues to be negotiable and the undischarged parties remain liable on it. For example, the non-presentment of a bill on the due date discharges the endorsers from their liability, but the acceptor remains liable on it.

A party may be discharged in the following ways :

(a) *By cancellation* by the holder of the name of any party to it with the intention of discharging him.

(b) *By release*, when the holder releases any party to the instrument

(c) *Discharge* of secondary parties, i.e., endorsers.

(d) *By the operation* of the law, i.e., by insolvency of the debtor.

(e) *By allowing* drawee more than 48 hours to accept the bill, all previous parties are discharged.

(f) *By non-presentment* of cheque promptly the drawer is discharged.

(g) *By taking qualified* acceptance, all the previous parties are discharged.

(h) *By material alteration*.

Material Alteration (Section 87)

An alteration is material which in any way alters the operation of the instrument and the liabilities of the parties thereto. Therefore, any change in an instrument which causes it to speak a different language in legal effect from that which it originally spoke, or which changes legal character of the instrument is a material alteration.

A material alteration renders the instrument void, but it affects only those persons who have already become parties at the date of the alteration. Those who take the altered instrument cannot complain. Section 88 provides that an acceptor or endorser of a negotiable instrument is bound by his acceptance or endorsement notwithstanding any previous alteration of the instrument.

Examples of material alteration are :

Alteration (i) of the date of the instrument (ii) of the sum payable, (iii) in the time of payment, (iv) of the place of payment,(v) of the rate of interest, (vi) by addition of a new party, (vii) tearing the instrument in a material part.

There is no material alteration and the instrument is not vitiated in the following cases:

(i) correction of a mistake, (ii) to carry out the common intention of the parties, (iii) an alteration made before the instrument is issued and made with the consent of the parties, (iv) crossing a cheque, (v) addition of the words “on demand” in an instrument where no time of payment is stated.

Section 89 affords protection to a person who pays an altered note bill or cheque. However, in order to be able to claim the protection, the following conditions must be fulfilled:

(i) the alteration should not be apparent;

(ii) the payment must be made in due course; and

(iii) the payment must be by a person or banker liable to pay.

Section 89 has been amended to provide for the amendment in the definition of cheque so as to provide for electronic image of a truncated cheque. The section provides that any bank or a clearing house which receives a transmitted electronic image of a truncated cheque, shall verify from the party who transmitted the image to it, that the image so transmitted to it and received by it, is exactly the same. Where there is any difference in apparent tenor of such electronic image and the truncated cheque, it shall be a material alteration. In such a case, it shall be the duty of the bank or the clearing house, as the case may be, to ensure the exactness of the apparent tenor of electronic image of the truncated cheque while truncating and transmitting the image. If the bank fails to discharge this duty, the payment made by it shall not be regarded as good and it shall not be afforded protection.*****

Retirement of a Bill under Rebate

An acceptor of a bill may make payment before maturity, and the bill is then said to be retired, but it is not discharged and must not be cancelled except by the acceptor when it comes into his hands. It is customary in such a case to make allowance of interest on the money to the acceptor for the remainder of the time which the bill has to run. The interest allowance is known as rebate.

Hundis

Hundis are negotiable instruments written in an oriental language. They are sometimes bills of exchange and sometimes promissory notes, and are not covered under the Negotiable Instruments Act, 1881. Generally, they are governed by the customs and usages in the locality but if custom is silent on the point in dispute before the Court, this Act applies to the hundis. The term "hundi" was formerly applicable to native bills of exchange. The promissory notes were then called "teep". The hundis were in circulation in India even before the present Negotiable Instrument Act, 1881 came into operation. The usages attached to these hundis varied with the locality in which they were in circulation.

Generally understood, the term "hundi" includes all indigenous negotiable instruments whether they are bills of exchange or promissory notes. An instrument in order to be a hundi must be capable of being sued by the holder in his own name, and must by the custom of trade be transferred like cash by delivery. Obviously the customs relating to hundis were many. In certain parts of the country even oral acceptance was in vague.

The following types of hundis are worth mentioning :

1. Shah Jog Hundi

"Shah" means a respectable and responsible person or a man of worth in the bazar. Shah Jog Hundi means a hundi which is payable only to a respectable holder, as opposed to a hundi payable to bearer. In other words the drawee before paying the same has to satisfy himself that the payee is a 'SHAH'.

2. Jokhmi Hundi

A "jokhmi" hundi is always drawn on or against goods shipped on the vessel mentioned in the hundi. It implies a condition that money will be paid only in the event of arrival of the goods against which the hundi is drawn. It is in the nature of policy of insurance. The difference, however, is that the money is paid before hand and is to be recovered if the ship arrives safely.

3. Jawabee Hundi

According to Macpherson, "A person desirous of making a remittance writes to the payee and delivers the letter to a banker, who either endorses it on to any of his correspondents near the payee's place of residence, or negotiates its transfer. On the arrival, the letter is forwarded to the payee, who attends and gives his receipt in the form of an answer to the letter which is forwarded by the same channel of the drawer or the order." Therefore, this is a form of hundi which is used for remitting money from one place to another.

4. Nam jog Hundi

It is a hundi payable to the party named in the bill or his order. The name of the payee is specifically inserted in the hundi. It can also be negotiated like a bill of exchange. Its alteration into a Shah Jog hundi is a material alteration and renders it void.

5. Darshani Hundi

This is a hundi payable at sight. It is freely negotiable and the price is regulated by demand and supply. They are payable on demand and must be presented for payment within a reasonable time after they are received by the holder.

6. Miadi Hundi

This is otherwise called *muddati* hundi, that is, a hundi payable after a specified period of time. Usually money is advanced against these hundis by shroffs after deducting the advance for the period in advance. There are other forms of hundis also like.

Dhani Jog Hundi - A hundi which is payable to "dhani" i.e., the owner.

Firman Jog Hundi - which is payable to order if can be negotiated by endorsement and delivery.

Presumptions of Law

A negotiable instrument is subject to certain presumptions. These have been recognised by the Negotiable Instruments Act under Sections 118 and 119 with a view to facilitate the business transactions. These are described below:

It shall be presumed that:

(1) Every negotiable instrument was made or drawn for consideration irrespective of the consideration mentioned in the instrument or not.

(2) Every negotiable instrument having a date was made on such date.

(3) Every accepted bill of exchange was accepted within a reasonable time before its maturity.

(4) Every negotiable instrument was transferred before its maturity.

(5) The instruments were endorsed in the order in which they appear on it.

(6) A lost or destroyed instrument was duly signed and stamped.

(7) The holder of the instrument is a holder in due course.

(8) In a suit upon an instrument which has been dishonoured, the Court shall presume the fact of dishonour, or proof of the protest.

However these legal presumptions are rebuttable by evidence to the contrary. The burden to prove to the contrary lies upon the defendant to the suit and not upon the plaintiff.

Payment of Interest in case of Dishonour

The Negotiable Instruments Act, 1881 was amended in the year 1988, revising the rate of interest as contained in Sections 80 and 117, from 6 per cent to 18 per cent per annum payable on negotiable instruments from the due date in case no rate of interest is specified, or payable to an endorser from the date of payment on a negotiable instrument on its dishonour with a view to discourage the withholding of payment on negotiable instruments on due dates.

Penalties in case of Dishonour of Cheques

Chapter XVII of the Negotiable Instruments Act provides for penalties in case of dishonour of certain cheques for insufficiencies of funds in the accounts. Sections 138 to 147 deal with these aspects.

Chapter XVII has been amended by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002. The amendments have provided the drawer with more time to send notice, made the punishment for the offence more stringent, given power to court for condonation of delay in filing of complaint, excluded liability of government nominated directors, made provision for summary trial of cases under the Chapter and time bound disposal of cases, have relaxed the rules of evidence, and made the offences under the Act compoundable.

The working of the provisions of Chapter XVII for a period of more than a decade had brought to the fore front various lacunae and shortcomings from which it suffered. It was seen that there were enormous delays in the disposal of the cases filed under Section 138 and the drawer of the cheques, by taking shield of various technicalities and procedures were frustrating the very object of the Chapter.

The provisions contained in this Chapter provide that where any cheque drawn by a person for discharge of any liability is returned by the bank unpaid for the reason of insufficiency of the amount of money standing to the credit of the account on which the cheque was drawn or for the reason that it exceeds the arrangement made by the drawer of the cheque with the banker for that account, the drawer of such cheque shall be deemed to have committed an offence. In that case, the drawer, without prejudice to the other provisions of the Act, shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to twice the amount of the cheque, or with both.

In order to constitute the said offence

(a) such cheque should have been presented to the bank within a period of six months from the date on which it is drawn or within the period of its validity, whichever is earlier; and

(b) the payee or holder in due course of such cheque should have made a demand for the payment of the said amount of money by giving notice, in writing, to the drawer of the cheque within thirty days of the receipt of information by him from the bank regarding the return of the cheque unpaid; and

(c) the drawer of such cheque should have failed to make the payment of the said amount of money to the payee or the holder in due course of the cheque within fifteen days of the receipt of the said notice.

It has also been provided that it shall be presumed, unless the contrary is proved, that the holder of such cheque received the cheque in the discharge of a liability. Defences which may or may not be allowed in any prosecution for such offence have also been provided to make the provisions effective. The Supreme Court in *Modi Cements Ltd.* v. *K.K. Nandi, (*1988) 28 CLA 491, held that merely because the drawer issued a notice to the drawee or to the Bank for 'stop payment', it would not preclude an action under Section 138 by the drawee or holder in due course.

The liability of government nominated directors has been excluded under Section 141 of the Act dealing with 'offences by companies'. The second proviso inserted in Section 141 by the Amendment Act, 2002 provides that where a person is nominated as a director of a company by virtue of his holding any office or employment in the Central Government or State Government or a financial corporation owned or controlled by the Central Government or the State Government, as the case may be, he shall not be liable for prosecution under this Chapter. In order to ensure that genuine and honest bank customers are not harassed or put to inconvenience, sufficient safeguards have also been provided in the new Chapter, as under:

(a) that no court shall take cognizance of such offence except on a complaint in writing, made by the payee or the holder in due course of the cheque;

(b) that such complaint is made within one month or the date on which the cause of action arises;

*****Provided that the cognizance of a complaint may be taken by the court after the prescribed period, if the complainant satisfies the court that he had sufficient cause for not making the complaint within such period.

(c) that no court inferior to that of a Metropolitan Magistrate or a Judicial magistrate of the first class shall try any such offence. (Section 142)

Moreover, the new Sections inserted by the Amendment Act, 2002 provide that all offences under this Chapter shall be tried by a Judicial Magistrate of the first class or by a Metropolitan Magistrate and the provisions of Sections 262 to 265 (both inclusive) of the said Code shall, as far as may be, apply to such trials:

Provided that in the case of any conviction in a *summary trial* under this Section, it shall be lawful for the Magistrate to pass a sentence of imprisonment for a term not exceeding one year and an amount of fine exceeding five thousand rupees:

Provided further that when at the commencement of, or in the course of, a summary trial under this Section, it appears to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Magistrate shall, after hearing the parties, record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear the case in the manner provided by the said Code.

(2) The trial of a case under this Section shall, so far as practicable, consistently with the interests of justice, be continued from day to day until its conclusion, unless the court finds the adjournment of the trial beyond the following day to be necessary for reasons to be recorded in writing.

(3) Every trial under this Section shall be conducted as expeditiously as possible and an endeavour shall be made to conclude the trial within six months from the date of filing of the complaint. (Section 143)

A Magistrate issuing a summons to an accused or a witness may direct a copy of summons to be served at the place where such accused or witness ordinarily resides or carries on business or personally works for gain, by speed post or by such courier services as are approved by a Court of Session.

Where an acknowledgement purporting to be signed by the accused or the witness or an endorsement purported to be made by any person authorised by the postal department or the courier services that the accused or the witness refused to take delivery of summons has been received, the court issuing the summons may declare that the summons has been duly served. (Section 144)

The evidence of the complainant may be given by him on affidavit and may, subject to all just exceptions be read in evidence in any enquiry, trial or other proceeding under the said Code.

The court may, if it thinks fit, and shall, on the application of the prosecution or the accused, summon and examine any person giving evidence on affidavit as to the facts contained therein. (Section 145)

The court shall, in respect of every proceeding under this Chapter, on production of bank's slip or memo having thereon the official mark denoting that the cheque has been dishonoured, presume the fact of dishonour of such cheque, unless and until such fact is disproved. Every offence punishable under this Act shall be compoundable. (Sections 146 and 147)

The practical effect of these amendments which have only recently been brought into force would be seen with time to come but it is expected that they would go a long way in making the remedy provided for by Chapter XVII meaningful and effective.

LESSON ROUND UP

- The law relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881. It is an Act to define and amend the law relating to promissory notes, bills of exchange and Cheques.
- The term *“negotiable instrument”* means a document transferable from one person to another.
- According to this definition the following are the conditions of negotiability:
  - The instrument should be freely transferable. An instrument cannot be negotiable unless it is such and in such state that the true owner could transfer by simple delivery or endorsement and delivery.
  - The person who takes it for value and in good faith is not affected by the defect in the title of the transferor.
  - Such a person can sue upon the instrument in his own name.
- The Act recognizes only three kinds of negotiable instruments under Section 13 but it does not exclude any other negotiable instrument provided the instrument entitles a person to a sum of money and is transferable by delivery.
  - Promissory Notes
  - Bills of Exchange
  - Cheques
- A “promissory note” is an instrument in writing containing an unconditional undertaking, signed by the maker to pay a certain sum of money to, or to the order of, a certain person, or only to bearer of the instrument.
- To be a promissory note, an instrument must possess the following essentials
  - be in writing
  - contain an express promise
  - undertaking to pay must be unconditional
  - maker must sign the promissory note
  - maker
  - payee must be certain
  - sum payable must be certain
  - be properly stamped in accordance with the provisions of the Indian Stamp Act
- A “bill of exchange” is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of, a certain person or to the bearer of the instrument.
- Bills of exchange were originally used for payment of debts by traders residing in one country to another country with a view to avoid transmission of coin. Now-a-days they are used more as trade bills both in connection with domestic trade and foreign trade and are called inland bills and foreign bills respectively.
- A ‘Cheque’ is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated Cheque and a Cheque in the electronic form

GLOSSARY

Negotiable Instrument	"Negotiable instrument" means a document transferable from one person to another. However the Act has not defined the term. It merely says that "A negotiable instrument" means a promissory note, bill of exchange or Cheque payable either to order or to bearer.
Inland Instruments	A promissory note, bill of exchange or cheque drawn or made in India, and made payable, or drawn upon any person, resident in India shall be deemed to be an inland instrument
Foreign Instruments	An instrument which is not an inland instrument, is deemed to be a foreign instrument. it must be drawn outside India
Inchoate or Incomplete Instrument	When one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments, and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein, and not exceeding the amount, covered by the stamp.
Trade Bill	A bill drawn and accepted for a genuine trade transaction is termed as a trade bill.
Accommodation Bill	All bills are not genuine trade bills, as they are often drawn for accommodating a party. Accommodation bill is a bill in which a person lends or gives his name to oblige a friend or some person whom he knows or otherwise.
Collecting Banker	Collecting Banker is one who collects the proceeds of a cheque for a customer.
Endorser	Person who, by signing a negotiable instrument, transfers the title of the instrument (or the property named therein) to another.
Holder	A person is a holder of a negotiable instrument who is entitled in his own name (i) to the possession of the instrument, and (ii) to recover or receive its amount from the parties thereto.
Holder in Due Course	A holder in due course is (i) a person who for consideration, obtains possession of a negotiable instrument if payable to bearer, or (ii) the payee or endorsee thereof, if payable to order, before its maturity and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.
Hundis	Hundis are negotiable instruments written in an oriental language. They are sometimes bills of exchange and sometimes promissory notes, and are not covered under the Negotiable Instruments Act, 1881.

SELF-TEST QUESTIONS

1. Define negotiable instrument. Make a distinction between a Bill and a Cheque.
2. Discuss the provisions relating to paying banker and what is meant by payment in due course?
3. What is crossing of a Cheque? Discuss various modes of crossing of a Cheque.
4. What is hundi? Describe some of the important hundis.
5. Write short notes on following:
   (i) Accommodation Bill
   (ii) Holder-in-due course
   (iii) Endorsement.
   (iv) Inland and foreign instruments.
   (v) Stale Cheque.
6. Describe legal presumption in case of negotiable instruments.
7. Discuss the penal provisions in case of dishonor of Cheque?
8. A draws a bill payable three months after sight on B. It passes several hands before X becomes its holder on presentation by X, B refuses to accept the bill. Discuss the rights of X.

Suggested Readings

(1) The Negotiable Instruments Act, 1881 – *Bare Act*

(2) A Manual of Mercantile Law – *M. C. Shukla*

(3) Negotiable Instruments Act – *Khergamwala*

(4) The Negotiable Instruments Act – *Bhashyam & Adiga* (Revised by *J.C. Verma*, Bharat Law House Pvt. Ltd., New Delhi)

MULTIPLE CHOICE QUESTIONS

Q.1 Is a minor personally liable for signing a note for necessaries?

Q.2 Will omission of the date invalidated the negotiable instrument?

Q.3 A negotiable instrument in which no time for payment is specified is payable :

(a) on demand (b) after a specified period

(b) after acceptance (d) after sight

Q.4 The presentment for acceptance is required in case of a :

(a) Cheque (b) Hundi

(b) Bill of exchange (d) None of the above

Q.5 The Payment of crossed cheque can be obtained:

(a) by the payee only (b) by the payor only

(b) by depositing in account (d) None of the above

Q.6 Hundi is also known as :

(a) zickri chit (b) perpeth

(b) maidi hundi (d) peth

Q.7 A Hundi which is payable 'at sight' is known as :

(a) darshani hundi (b) zikri hundi

(b) haidi hundi (d) None of above

Q.8 The negotiable instruments on demand, is due for payment:

(a) from the date of issue (b) next day is issue

(b) after 10 days of date of issue(d) after 20 days of date of issue

Q.9 In case of dishonour of cheque, the holder's remedy is against the:

(a) drawee of cheque (b) payer of cheque

(b) drawer of cheque (d) both (a) and (b)

Q.10 What is liability of the maker of promissory note and acceptor of a bill of exchange:

(a) conditional (b) secondary

(b) primary (d) none of these

Q.11 A negotiable instrument payable to order can be transferred by :

(a) simply delivery (b) indorsement

(b) delivery (d) registered post

Q.12 A bill of exchange payable to bearer on demand is:

(a) voidable (b) conditional

(b) invalid (d) voidable at acceptance

Q.13 Which are the characteristics of negotiable instruments :

(a) It must be in writing (b) it must contain definite amount of money

(c) it must be freely transferable (d) all of above

Q.14 Essential of a promissory note?

(a) It must be in stamped (b) it must be signed by maker

(c) both (a) and (b) (d) none of above

Q.15 Essential feature to become a "holder in due course" of a negotiable instrument

(a) in good faith (b) for consideration

(b) both (a) and (b) (d) none of the above

Q.16 What is meant by material alteration:

(a) alteration of time of payment (b) alteration of amount

(c) alteration of date (d) all of the above

Q.17 A hundi when paid-up and canceled, call:

(a) perpeth (b) khoka

(c) purya (d) none of these

Q.18 An indorsement made be indorser by signing his name and writing the name of the indorsee, known as :

(a) general indorsement (b) restrictive indorsement

(c) special indorsement (d) none of these

Q.19 A person by acceptance of a bill of exchange from drawee:

(a) acceptor (b) acceptor for honour

(c) drawee in case of need (d) none of these

Q.20 Negotiable instrument payable outside India and drawn on a person residing in India, known as:

(a) inland instrument (b) foreign instrument

(c) both (a) and (b) (d) none of these

PART C
ENTREPRENEURSHIP

LESSONS

Entrepreneurship is one of the driving forces of the modern global economy. It is a primary source of job creation, prosperity, and economic competitiveness. Economy, if it is to remain competitive, needs more entrepreneurial people. In particular, it needs the creativity of people of the economy. Entrepreneurship, in its widest sense, is any enterprise or effort that adds value to the lives of the people on whom, it has an impact. Change that adds value to peoples' lives, lies at the heart of entrepreneurship. Entrepreneurship is popularly understood as the setting up new business ventures. In this context, the emphasis is on business start-ups and on identifying and helping those with the determination so as to develop the competencies to set up and manage a business enterprise. Entrepreneurial people are innovative problem solvers. Everything all around us in some way has its roots in entrepreneurship. Products, systems, and ideas are all part of an entrepreneurial ecosystem. No society can exist without entrepreneurship. Every society depends on entrepreneurs. The subject of entrepreneurship requires understanding of the specific conditions faced by entrepreneurs. The above are pertinent issues which require focus that this part on entrepreneurship will address.

Lesson 13
Entrepreneurship

LESSON OUTLINE

- Introduction
- Four Key Elements of Entrepreneurship
  - Innovation
  - Risk taking
  - Vision
  - Organising skills
- Who is an Entrepreneur?
- Characteristics
- Why Entrepreneurship?
- Types of Entrepreneur
- Entrepreneur vs. Manager
- Intrapreneurship
- Difference between an Entrepreneur and an Intrapreneur
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

Entrepreneurship is central for enhancing the economic opportunity of nations and organizations. Entrepreneurs create and exploit change, are innovative and have the ability to mobilize resources to create value by invention of, or improvement of existing products or services. One reason for the emerging need of Entrepreneurship is because it constitutes, in many respects, the factors requisite for economic development.

The idea of starting a business is appealing to many people. This is the trait for entrepreneur temper. Entrepreneurs must be able to sustain the drive and energy required to form something new and to manage the new enterprise. McClelland concluded that a high need for achievement leads individuals to engage in entrepreneurial behavior.

This is where this lesson on entrepreneurship will help develop entrepreneurial learning among students either entering industry or setting up their own businesses. Entrepreneurial learning concerns knowledge, skills, abilities and attitudes of actual or potential entrepreneurs. It concerns the development of entrepreneurial capabilities through life and work.

Enterprise is living a few years of your life like most people won't so you can spend the rest of your life like most people don't.

A Student in Warren G. Tracy's Class

INTRODUCTION

Entrepreneurship is defined as the process of making money, earning profits and increasing the wealth while posing characteristics such as risk taking, management, leadership and innovation. The term Entrepreneurship is a complicated term and gives various meaning depending on the situation.

The word entrepreneur has a French origin. It originated during the Middle Ages when the term entrepreneur was applied to *"the man in charge of the great architectural works: castles and fortifications, public buildings, abbeys and cathedrals*". It is derived from the French word, *entreprendre*, which means "to undertake." In a business context, it means to undertake a business activity or simply to start a business. The Merriamtebster Dictionary defines an entrepreneur as 'one who organizes, manages, and assumes the risks of a business or enterprise'.

The concept of Entrepreneurship has wide range of meanings. On one extreme an entrepreneur is a person of very high aptitude who pioneers change, possessing characteristics found in only a very small fraction of the population. On the other extreme, anyone who wants to work for himself is considered to be an entrepreneur. That is, entrepreneurship is equated to simply starting one's own business. Most economists believe it is more than that. To some economists, the entrepreneur is one who is willing to bear the risk of a new venture if there is a significant chance for profit. Others emphasize the entrepreneur plays a role of an innovator who markets his innovation. Still other economists say that entrepreneurs develop new goods or processes that the market demands and are not currently being supplied.

The concept of entrepreneurship was first established in the 1700s, and the meaning has evolved ever since. Various economists and philosophers termed this differently in their own unique ways.

Cantillon referred entrepreneurs as one of the classes of 'landowners' who are financially independent aristocrats. For him; individuals who purchased a good at a certain price, used that good to produce a product and then sold that product at an uncertain price could be considered 'entrepreneurs'. Risk and uncertainty play central parts in his theory of the economic system. Successful entrepreneurs were those individuals who made better judgments about changes in the market and who coped with risk and uncertainty better than their counterparts. The entrepreneurial motivation is one of the most important factors which accelerate the pace of economic development by bringing the people to undertake risk bearing activities.

Four Key Elements of Entrepreneurship

- Innovation
- Risk taking
- Vision
- Organising skills

In many of the developing countries a lot of attention is being paid to the development of entrepreneurship because it is not the proprietary quality of any caste and community. The entrepreneurship is usually understood with reference to individual business. Entrepreneurship has rightly been identified with the individual, as success of enterprise depends upon imagination, vision, innovativeness and risk taking. The production is possible due to the cooperation of the various factors of production, popularly known as land, labour, capital, market, management and of course entrepreneurship. The entrepreneurship is a risk taking factor, which is responsible for the end result in the form of profit or loss.

The early history of entrepreneurship in India reflects from the culture, customs and tradition of the India people. The Baliyatra Festival of Cuttack, Orissa reminiscence of past glory of International trade. The process of entrepreneurship, therefore passed through the potential roots of the society and all those who accepted entrepreneurial role had the cultural heritage of trade and business. Occupational pursuits opted by the individual under the caste system received different meaning of value attached to entrepreneurship, which is based on social sanctions.

As society grew and the process of business occupation depended and the value work tended towards change and the various occupational role interchanged with non-role group and sub-groups. People from different castes and status also entered into the entrepreneurial role. The emergence of entrepreneurship in this part of the country got localized and spread effect, took its own time. The concept of growth theory seems to be closely related in explaining the theory of entrepreneurship development as well.

In the 20th century, economist Joseph Schumpeter (1883-1950) focused on how the entrepreneur's drive for innovation and improvement creates upheaval and change. Schumpeter viewed entrepreneurship as a force of "creative destruction." The entrepreneur carries out "new combinations," thereby helping render old industries obsolete. Established ways of doing business are destroyed by the creation of new and better ways to do them. According to A Schumpeter "The entrepreneurship is essentially a creative activity or it is an innovative function".

After the Second World War, entrepreneurship received new meaning for attaining economic development within the shortest possible time; as concern for economic development became all-pervasive. There was a growing concern for economic development and this strengthened interest in enterprises. This led to the development of the entrepreneurship in India.

Business expert Peter Drucker (1909-2005) took this idea further, describing the entrepreneur as someone who actually searches for change, responds to it, and exploits those changes as an opportunity. For instance; a change converted from typewriters to personal computers to the Internet. According to Peter P Drucker, "Entrepreneurship is neither a science nor an art. It is a practice. It is knowledge based. Knowledge in entrepreneurship is a means to an end, that is, by the practice."

The culture of a community also may influence how much entrepreneurship there is within it. Different levels of entrepreneurship may stem from cultural differences that make entrepreneurship more or less rewarding personally. A community that accords the highest status to those at the top of hierarchical organizations or those with professional expertise may discourage entrepreneurship. A culture or policy that accords high status to the "self-made" individual is more likely to encourage entrepreneurship.

In crux these are various interchangeable meanings of what is entrepreneurship.

- A theory of evolution of economic activities.
- A continuous process and an ingredient of economic development.
- Essentially a creative activity or an innovative function.
- A risk taking factor which is responsible for an end result.
- The name given to the factor of production, which performs the functions of enterprise.
- Creates awareness among people about economic activity.
- Generates Self-employment and additional employment.

TRAITS OF AN ENTREPRENUER

- He is a person who develops and owns his own enterprise.
- He is a moderate risk taker and works under uncertainty for achieving the goal.
- He is innovative.

– He peruses the deviant pursuits.
– Reflects strong urge to be independent.
– Persistently tries to do something better.
– Dissatisfied with routine activities.
– Prepared to withstand the hard life.
– Determined but patient.
– Exhibits sense of leadership.
– Also exhibits sense of competitiveness.
– Takes personals responsibility.
– Oriented towards the future.
– Tends to persist in the face to adversity.
– Convert a situation into opportunity.

Who is an Entrepreneur?

Entrepreneurship is a very famous word amongst the business community life. But, there are many common people still cannot get the definition and the meaning for who is the entrepreneur. 'One who undertakes an endeavor' is the meaning of the French word entrepreneur. There is no one definitive profile. Successful entrepreneurs come in various ages, income levels, gender, and race. They differ in education and experience. But research indicates that most successful entrepreneurs share certain personal attributes, including: creativity, dedication, determination, flexibility, leadership, passion, self-confidence, and "smarts."

Creativity is the spark that drives the development of new products or services or ways to do business. It is the push for innovation and improvement. It is continuous learning, questioning, and thinking outside of prescribed formulas.

Dedication is what motivates the entrepreneur to work hard, 12 hours a day or more, even seven days a week, especially in the beginning, to get the endeavour off the ground. Planning and ideas must be joined by hard work to succeed. Dedication makes it happen.

Determination is the extremely strong desire to achieve success. It includes persistence and the ability to bounce back after rough times. It persuades the entrepreneur to make the 10th phone call, after nine have yielded nothing. For the true entrepreneur, money is not the motivation. Success is the motivator; money is the reward.

Flexibility is the ability to move quickly in response to changing market needs. It is being true to a dream while also being mindful of market realities. A story is told about an entrepreneur who started a fancy shop selling only French pastries. But customers wanted to buy muffins as well. Rather than risking the loss of these customers, the entrepreneur modified her vision to accommodate these needs.

Leadership is the ability to create rules and to set goals. It is the capacity to follow through to see that rules are followed and goals are accomplished.

Passion is what gets entrepreneurs started and keeps them there. It gives entrepreneurs the ability to convince others to believe in their vision. It can't substitute for planning, but it will help them to stay focused and to get others to look at their plans.

Self-confidence comes from thorough planning, which reduces uncertainty and the level of risk. It also comes from expertise. Self-confidence gives the entrepreneur the ability to listen without being easily swayed or intimidated.

“Smarts” consists of common sense joined with knowledge or experience in a related business or endeavour. The former gives a person good instinct, the latter, expertise. Many people have smarts they don’t recognize. A person who successfully keeps a household on a budget has organizational and financial skills. Employment, education, and life experiences all contribute to smarts.

Every entrepreneur has these qualities in different degrees. But what if a person lacks one or more? Many skills can be learned. Or, someone can be hired who has strengths that the entrepreneur lacks. The most important strategy is to be aware of strengths and to build on them.

Characteristics of an Entrepreneur

(i) *Mental Ability:* entrepreneur must have creative thinking and must be able to analyse problems and situations. He should be able to anticipate changes.

(ii) *Business Secrecy*: he should guard his business secrets from his competitors.

(iii) *Clear Objectives:* he must have clear objectives as to the exact nature of business or the nature of goods to be produced.

(iv) *Human Relation:* he must maintain good relations with his customers, employees etc. to maintain good relationship he should have emotional stability, personal relations, tactfulness and consideration.

(v) *Communication Ability:* he should have good communication skills means both the sender and the receiver should understand each others message.

Why Entrepreneurship

What leads a person to strike out on his own and start a business? The answer lies in the advantages of entrepreneurship.

1. Doing What You Love

If an entrepreneur is going to start his business it is assured he will get better odds to succeed if he is doing something he loves. Why? Because, passion is the fuel that is needed to face all the obstacles.

It is natural to feel fearful to fail. But to start with ones own business is like leaving Comfort Zone and entering a Twilight Zone. It is an activity where it should be ensured to strike balance between the business what you love to do and which is profitable as well.

Additionally in the business jungle; it is of utter most importance to survive being one of the best and that is easier if the entrepreneur is passionate about what he is doing.

Therefore, one of the advantages of being an entrepreneur is doing what one loves.

“Choose a job that you like and you will never have to work a day in your life.”

– Confucius

2. Independence and Freedom

Entrepreneurship allows undertaking the activities of one’s choice and comfort which offers independence and freedom in return. Many people think independence and freedom means going to work or take vacations when you want or need. The truth is that is not possible at least in the earlier years of business. On the other hand, when business is mature, strong and self sufficient, it begins to offer independence and financial freedom.

“Entrepreneurship is living a few years of your life like most people won’t, so that you can spend the rest of your life like most people can’t” – A Student in Warren G. Tracy’s Class

3. Recognition and Self Fulfilment

Entrepreneurship provides the ability to be involved in the total operation of the business, from concept to design and creation, from sales to business operations and customer response.

It offers the prestige of being the person in charge.

In line with the Maslow's hierarchy of needs, it is human to desire for recognition and strive for self fulfillment and achievement. Entrepreneurship offers excitement compared to being regular employees. Entrepreneurs enjoy much excitement beginning from the planning stage of the business up to development and realization. Thrill-seekers obviously love being entrepreneurs as they are exposed to too much risk.

"What a man can be, he must be. This need we call self actualization." – Maslow

"I have wandered all my life, and I have also traveled; the difference between the two being this, that we wander for distraction, but we travel for fulfillment." – Hilaire Belloc

4. Income Potential

Entrepreneurship offers a greater possibility of achieving significant financial rewards than working for someone else.

This is a big one because when you're an entrepreneur you can create a direct relationship between your efforts and your income. In other words: if your efforts are higher your reward should be higher too. Of course that happens if your efforts are well planned, effective and well focused.

Many people really believe that of all the advantages of being an entrepreneur this is the best. That's probably because in comparison to a job where employer, the company's financial budget, the Board and the economy decides salary. In case of an entrepreneur nobody except the market forces defines returns and income.

"A large income is the best recipe for happiness I ever heard of." – Jane Austen quotes

5. Own Boss

Entrepreneurs are their own bosses. They make the decisions. They choose whom to do business with and what work they will do. They decide what hours to work, as well as what to pay and whether to take vacations.

"Your real boss is the one who walks around under your hat." –Napoleon Hill

6. Innovation

Entrepreneurship creates an opportunity for a person to make a contribution. Most new entrepreneurs help the local economy. A few – through their innovations – contribute to society as a whole. One example is entrepreneur Steve Jobs, who co-founded Apple in 1976, and the subsequent revolution in desktop computers.

It gives an individual the opportunity to build equity, which can be kept, sold, or passed on to the next generation.

TYPES OF ENTREPRENEUR

Starting and growing one's own business requires many skills to be successful. One could be a visionary like Bill Gates or a superstar like Peter Sematimba. The entrepreneur personality types are the traits and characteristics that blend with the needs of the business. Understanding the types of entrepreneur personality type helps in enjoying business as well as providing with what it needs to grow in best.

Each entrepreneur personality type can succeed in the business environment if it is true to character. Identifying strong traits is essential and can act as a compass for the business.

1. Idealist

The idealist entrepreneur is the most common type of entrepreneur. He likes innovation and enjoys working on something new or creative. He is guided by more ideals while keeping in view the ideas that are formulated by him in order to pursue his innovation.

2. Optimizers

The optimizer entrepreneur comes in a close second and is content with the personal satisfaction of simply being a business owner. It is derived from being optimistic.

3. Hard Workers

The hard workers entrepreneur category includes persons who enjoy putting in long hours to build a larger and more profitable business. They like to challenge themselves and strive harder to attain the same. They reap the most rewards if the business turns out to be a multi-million dollar enterprise.

Hard work comes with all businesses but not everyone works hard for the business to grow as this type of entrepreneurs does.

4. Sustainers

As the meaning of the word itself implies, sustain is to maintain; the sustainer type of entrepreneurs comprise of people who like to maintain a balance between work and a personal life. Most often, they do not wish the business to grow too large where it will cut into their personal life. These people just need enough to survive.

5. Improver

The improver types of entrepreneur are the ones who predominantly are focused to start a business to improve the world. Their motto is to work in a manner which is morally and ethically correct so as to contribute to a noble cause. Improvers have an unwavering ability to run their businesses with high integrity. At the same time, these people need to be aware of their tendency of being over critical of employees and clients in order to be a perfectionist.

6. Advisor

These types of people believe in consumer sovereignty where they indulge excessively in providing customer services. This business personality type will provide an extremely high level of assistance and advice to customers. They want to please their customers. Their businesses soon become customer oriented business which involves providing advisory services to them at a cost to themselves.

7. Superstar

This type of entrepreneur is lead by charisma, charm and high energy. An entrepreneur like this has an overwhelming personality which works in his favour so does in the favour of business. This personality often will cause to build business around own personal brand. However, such people tend to become too competitive and workaholics; which can sour the workplace and the market. Entrepreneur example is Peter Sematimba, CEO of Super FM.

8. Artiste

These are creativity oriented entrepreneurs. Thus, the type of business also are those which demand huge levels of creativity such as; advertising agencies and people in the music industry. The artist involves in business activity which is centered around their talents and creative fields. The limitation faced by such entrepreneur is that of over sensitively reacting to the customers feedbacks if such is a negative one.

9. Visionary

Normally, all the businesses are founded keeping a vision in mind. The founding members who visualize a dream and materialize the same are known as visionary. These are thinkers who pursue to make their vision come true. Such people are curious in nature and have a long sighted vision which helps them in understanding the world around better thereby to set up plans to avoid pitfall and hurdles. At the same time, these people lack to relate their dreams with reality which might result in opposite results when it comes to starting up all new. Thus it is advisable to act before visualizing.

10. Analyst

These types of entrepreneurs excel at problem solving in a systematic way. Thus businesses involving complications suit them a lot. They are able to crop up the solution at no cost and less time. The challenge is to realize that too much analysis can result in no action being taken. Secondly, they might get caught in analysis paralysis.

11. Fireball

Fireball is a casual word used for an energetic person so does it imply for entrepreneurs. A business owned and operated by a fireball is full of life, energy and optimism. Such businesses are life energizing and makes customers feel the firm has a get it done attitude. Since every coin has two sides, such people have a downside too. In being too outright and energetic, they may over commit and act too impulsively. Maintaining a balance for impulsiveness with sensitive planning is of utter most importance.

12. Jugglers

A juggler conventionally means entertainer who keeps several plates, knives, balls, or other objects in the air at once by tossing and catching them. The art of juggling has been practiced since antiquity. The juggler entrepreneur likes the concept that the business gives them a chance to handle everything themselves. They are usually people with lots of energy and exist on the pressure of meeting deadlines, paying bills and of course making payroll.

13. Hero

Hero like entrepreneurs are the people with great willingness and efficient leadership. He inspires others. He has an incredible will and ability to lead the world and the business through any challenge. He is the essence of entrepreneurship and can assemble great companies. Over promising and using force full tactics to get the way out are the bane sides of being a hero entrepreneur; which definitely is not fruitful in long term.

14. Healer

Healer as the name suggest, nurtures the business by bringing harmony with a surprising ability to survive with an inner calm. Healer is closely related to calmness which lets him avoid the outside harsh realities of business. One must keep a scenario planning to pre prepare for any kind of turmoil.

ENTREPRENEUR vs. MANAGER

For many entrepreneurs, one of the most difficult tasks is to make the successful transition from a creative, task-juggling entrepreneur to a business-skill-applying manager.

The terms Entrepreneur and Manager are considered same; but these have different meanings altogether. These cannot be used interchangeably. The following are some of the differences between a manager and an entrepreneur.

– The main difference between the two terms is that an entrepreneur starts a business enterprise constituting of ideas he comprehends; employing personal stakes in it where as a manager provides his services in an enterprise established by entrepreneur.

– An entrepreneur and a manager differ in their standing, an entrepreneur is the owner of the organization and he bears all the risk and uncertainties involved in running an organization where as a manager is an employee and does not undertake responsibilities for any risk.

– An entrepreneur and a manager differ in their objectives. Entrepreneur's objective is to innovate and create and he acts as a change agent where as a manager's objective is to supervise and create routines. He implements the entrepreneur's plans and ideas.

– An entrepreneur is faced with more income uncertainties as his income is contingent on the performance of the firm where as a manager's compensation is less dependent on the performance of the organization.

– An entrepreneur is not induced to involve in fraudulent behavior where as a manger does. A manager may cheat by not working hard because his income is not tied up to the performance of the organization.

– Their areas of qualifications differ in the sense that; entrepreneur is required to have certain qualifications and qualities like high accomplishment motive, innovative thinking, forethought, risk-bearing ability etc. Conversely it's mandatory for a manager to be educated in the fields of management theories and practices.

"An entrepreneur could be a manager but a manager cannot be an entrepreneur". An entrepreneur is intensely dedicated to develop business through constant innovation. He may employ a manager in order to perform some of his functions such as setting objectives, policies, rules etc. A manager cannot replace an entrepreneur in spite of performing the allotted duties because a manager has to work as per the guidelines laid down by the entrepreneur.

REVIEW QUESTION

Fill in the Blanks:

1. An .... entrepreneur is the most common type of entrepreneur.

2. An .... is an individual who creates something for the first time, is a highly driven individual motivated by his or her own work and personal ideas.

Answers: 1. idealist 2. entrepreneur

INTRAPRENEURSHIP

Meaning

A dictionary meaning to word provides that, "A person within a large corporation who takes direct responsibility for turning an idea into a profitable finished product through assertive risk-taking and innovation is an intrapreneur." It is derived as INTRA (corporate) + (entre) PRENEUR].

The word intrapreneur is the recently coined corporate counterpart to long existing term entrepreneur. This coinage is generally attributed to management consultant Gifford Pinchot, author of the 1985 book entitled Intrapreneuring. Since inception of this term in the scant number of years, intrapreneur has gained momentum and currency very rapidly.

Intrapreneurship is a combination of entrepreneurship and management skills. In simple words, Intrapreneurship is the practice of entrepreneurship by employees within an organization. The trend today is such that every one who is capable of managing others business is himself indulging in entrepreneurship. This is resulting in inadequacy of management staff. In the emergence of this changing pattern, the concept of intrapreneurship is originated where the intrapreneur (i.e. Manager) is made the head of a given business unit and asked to manage it for the organization while employing innovative skills. As an example, when a company seeks for diversification options, they can appoint one of their managers as an intrapreneur to launch the business venture while allowing him to share the part of the profits made by the new business venture.

Features of Intrapreneurship

An intrapreneur thinks like an entrepreneur looking out for opportunities, which profits the organization. Intrapreneurship is a novel way of making organizations more profitable where employees entertain entrepreneurial thoughts. It is in the interest of an organization to encourage intrapreneurs. Intrapreneurship is a significant method for companies to reinvent themselves and improve performance. Managers would do well to take employees who do not appear entrepreneurial but can turn out to be good intrapreneurial choices.

Key Characteristics of Intrapreneurship

- It promotes the managers to be more innovative and take more responsibility while demonstrating charismatic leadership qualities.
- Intrapreneurship projects are funded by large business organization and agreed percentage of profits are remitted to the fund provider/head quarters of the business.
- Intrapreneurship will cultivate entrepreneurial skills/culture within the corporate culture where managers will be motivated to accept more risk.
- Due to the backing from the headquarters, the chances of failure are low when compared to start ups.
- It adds value to the life of the intrapreneur as he is being given the task of being an entrepreneur while receiving necessary training from headquarters.
- Business portfolio of funding organization will be expanded creating diversification.
- Finally, it creates wealth for the headquarters as well as for the intrapreneur through its profit sharing agreement.

Difference between an Entrepreneur and an Intrapreneur

An entrepreneur takes substantial risk in being the owner and operator of a business with expectations of financial profit and other rewards that the business may generate. On the contrary, an intrapreneur is an individual employed by an organization for remuneration, which is based on the financial success of the unit he is responsible for. Intrapreneurs share the same traits as entrepreneurs such as conviction, zeal and insight. As the intrapreneur continues to expresses his ideas vigorously, it will reveal the gap between the philosophy of the organization and the employee. If the organization supports him in pursuing his ideas, he succeeds. If not, he is likely to leave the organization and set up his own business.

The words entrepreneur and intrapreneur have acquired special significance in the content of economic growth in a rapidly changing industrial climate both in developed and developing countries. Entrepreneur is a key person who envisages new opportunities, new techniques, new lines of production, new products and coordinates all other activities. He likes to experiment with new ideas and thus, face uncertainty. He works for himself and for profits.

On the other hand, intrapreneurs are entrepreneurs who catch hold of a new idea for product service or process and work to bring this idea to fruition within the framework of the organisation. Intrapreneurs with their innovations and dedicated effort are perceived as valuable asset by the organisation, inspiring others. They serve as champions to others in those organizations. In America a number of business executives have left their jobs and started their own enterprises because they were not given chance to test and implement their innovative ideas. Later they achieved phenomenal success in their new venture and posed a threat to the companies they left. These executives turned entrepreneurs are known as intrapreneur.

The Entrepreneur is typically a visionary who spots an opportunity in the marketplace and has the passion, guile and contact base to set the wheels in motion. The Intrapreneur has passion and drive but also has the operational skills of running the "clockwork" of the business to enable a good idea to be turned into commercial reality. He is the "inside entrepreneur".

Both "preneurs" set themselves aside from employees in a number of ways but perhaps the most significant is in their relationship with the business. It's a question of commitment over involvement. Employees are involved, "preneurs" are committed.

Not every business needs an Entrepreneur, but every business needs an Intrapreneur.

In the same way that the seed of a business idea needs an Entrepreneur to shape and cultivate it, so the Entrepreneur needs the Intrapreneur to pluck from his grasp those seeds of opportunity, convert them in to a viable commercial plan and then manage that plan to a profitable reality. Without the intrapreneur, ideas entrepreneurs and small business are doomed to fail.

Intrapreneurship vs. Entrepreneurship

- Entrepreneurs can be found anywhere; whereas intrapreneurs are found, rather encouraged within the confines of an organization
- While entrepreneurs face hurdles in the form of ridicule and setbacks from the society in general; intrapreneurs have to face rivalry within the organization they work.
- Entrepreneurs find it difficult to arrange resources while these are readily available to intrapreneurs.

DISTINGUISHING FACTORS	MANAGER	ENTREPRENEUR	INTRAPRENEUR
Primary Focus	Salary Promotion Traditional corporate rewards	Independent Chance to be creative Opportunity to make more money	Independent Chance to be creative To move towards organizational and personal successes
Skills Required	Managing qualities like leadership, organizing, planning, communication skills etc.	Creativity, Innovative, Risk taking, Visionary, Passion, Dedication, Determination	Blend of managerial and entrepreneurial skills
Time Focus	Short term to meet deadlines set by top management	Survival and achieving long term growth	To meet self imposed deadlines
Activity Delegation	Delegated by top management	Delegated to oneself	Delegated to oneself

Amount of Risk Bearing	Conservative	Extreme	Moderate
Status Check	Concerned about status	Not concerned about status	Not concerned about status
Failure and Mistakes	Minimizes mistakes	Deals with mistakes	Reduces risky activities
Decision	Agrees with top management	Follows a dream	Gets help from others to achieve dreams
Availability of Resources	Readily available	Needs to arrange	Provided by Entrepreneur
Constituencies Served	Upper Management and Customers	Oneself and Customers	Oneself, Customers and Organization
Competitors	No one	Other entrepreneurs outside the organisation	Within the organisation

LESSON ROUND UP

– Entrepreneurship is defined as the process of making money, earning profits and increasing the wealth while posing characteristics such as risk taking, management, leadership and innovation. The term Entrepreneurship is a complicated term and gives various meaning depending on the situation.

– The concept of entrepreneurship was first established in the 1700s, and the meaning has evolved ever since.

– The entrepreneurial motivation is one of the most important factors which accelerate the pace of economic development by bringing the people to undertake risk bearing activities.

– Four Key Elements of Entrepreneurship:

- Innovation
- Risk taking
- Vision
- Organising skills

– One who undertakes an endeavor is an Entrepreneur. Most successful entrepreneurs share certain personal attributes, including: creativity, dedication, determination, flexibility, leadership, passion, self-confidence, and smarts.

– What leads a person to strike out on his own and start a business:

- Doing What You Love
- Independence and Freedom
- Recognition and Self Fulfilment

- Income Potential
- Own Boss
- Innovation

– Each entrepreneur personality type can succeed in the business environment if it is true to character. Identifying strong traits is essential and can act as a compass for the business.

– The terms Entrepreneur and Manager are considered same; but these have different meanings altogether. These cannot be used interchangeably.

– Intrapreneurship is a combination of entrepreneurship and management skills. Intrapreneurship is the practice of entrepreneurship by employees within an organization.

GLOSSARY

Idealist	One whose conduct is influenced by ideas.
Optimizers	One who is optimistic and has a drive for positivism.
Hard Workers	One whose conduct begins when he deals with the things he would rather not deal with. One who puts in loads of efforts to reach a predefined goal.
Sustainers	Sustainers are survivors who need just as much to sustain; keeping balance between different.
Improver	One who is devoted to the promotion of any noble cause.
Advisor	One who advices people on entrepreneurial ventures.
Superstar	One who with his charm establish and manages business to take it to unimaginable heights.
Artiste	These are the entrepreneurs who have an overstated inclination towards bringing creativity in the system.
Visionary	The visionary who starts a business with a fresh idea, to make something better or less expensively, to make it in a new way or to satisfy a unique need, is often not primarily interested in making money.
Analyst	These entrepreneurs work on analyzing the system and fixing problems in a systematic way.
Fireball	One who is never dull in terms of enthusiasm, energy and attitude.
Jugglers	People who works with lots of balls in air and a few in hand.
Hero	These entrepreneurs are risk taking heroes.
Healer	One who nurtures his business with harmony.

SELF-TEST QUESTIONS

1. What are the main factors on which the success of an entrepreneurship depends?
2. Under what circumstances is entrepreneurship discouraged?
3. How can entrepreneurship used as self employing tool?
4. What would you understand of the concept of self actualization in terms of entrepreneurship?
5. Discuss very briefly about the most ‘common type’ of entrepreneur.
6. You strive to reach your goal (or even beyond your goal). Which kind/type of entrepreneur are you?
7. Write a line about an entrepreneur who is always content? What is such an entrepreneur called?
8. Which category of entrepreneurship does Peter Sematimba fall in? ans-superstar
9. ‘An entrepreneur could be a manager but a manager cannot be an entrepreneur but a manager cannot be an entrepreneur”. Write a line to support the statement.
10. “Being a Hero entrepreneur might be harmful.” If you agree then support.
11. Write something about Intraprenuership. Who is the man to coin this word out?
12. How is intrapreneurship better when compared to entrepreneurship? State one strong reason.
13. “An analyst entrepreneur is at a risk, in his future years of business.” How do you agree to this?

Suggested Readings

(i) Entrepreneurial Development – by C. B. Gupta and N.P.Srinivasan, Sultan Chand & Sons, 1992.

Lesson 14
Entrepreneurship – Creativity and Innovation

LESSON OUTLINE

- Introduction
- Creativity
- Principles of Creativity
- Innovation
- Principles of Innovation
- Environment Scanning
  - SWOT Analysis
  - PEST/ PESTEL Analysis
  - Industry Analysis
- Environmental Scanning Process
- Types of Environmental Scanning
- Market Assessment
- Review Questions
- Assessment of Business Opportunities
- Developing Effective Business Plans
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

Innovation is tool of entrepreneurship. In addition, both of the stated demands creativity. Creativity and innovation by definition involves the creation of something new which is central to the entrepreneurial process. Creativity and innovation are considered inseparable from entrepreneurship, which is in turn manifested in the act of starting up and running an enterprise. Entrepreneurs and their start-ups are considered to be important agents of innovation, not simply in terms of the products and services they provide, but also in terms of the technologies and processes that they utilize. Start-up entrepreneurs could, thus be argued to be, by their very nature, the essence of creativity and innovation.

Creativity is applied because it connects, innovation is required because it implies progress and both play role in entrepreneurship. These fill in the vacuum created between an idea and an opportunity.

This lesson explores ways in which start-up entrepreneurs are creative and innovative, the ways in which such innovation and creativity can be explored better to derive entrepreneurial motivation which helps in setting up a business.

People always overestimate how complex business is. This isn't rocket science; we've chosen one of the world's more simple professions.

Jack Welch

INTRODUCTION

Innovation is the tool of entrepreneurship. In addition, both innovation and entrepreneurship demand creativity. Creativity is a process by which a symbolic domain in the culture is changed. Creativity is the ability to make or otherwise bring into existences something new, whether a new solution to a problem, a new method or device, or a new artistic object or form. Creativity is moving from the known to the unknown. No entrepreneur or enterprise, however successful and big, can continue to hold a place of leadership unless it recognizes that modern business operates in a world of galloping change which creates new problems, risk and opportunities and for which they have to mobilize the enterprise's resources before changes make their impact felt. All innovation begins with creative ideas. Creativity is the starting point for innovation. Creativity is however necessary but not sufficient condition for innovation. Innovation is the implantation of creative inspiration.

CREATIVITY

Creativity is marked by the ability to create, bring into existence, to invent into a new form, to produce through imaginative skill, to make to bring into existence something new. Creativity is not ability to create out of nothing but the ability to generate new ideas by combining, changing, or reapplying existing ideas. Every being has a creative side but is not realized.

Creativity is an attitude, the ability to accept change and newness, a willingness to play with ideas and possibilities, a flexibility of outlook, the habit of enjoying the good, while looking for ways to improve it.

Creativity is also a process. Creative people work hard to improve ideas and solutions, by making continuous and gradual alterations and refinements to their works.

Creativity requires passion and commitment.

Principles of Creativity

People become creative when they feel motivated primarily by the interest, satisfaction, and challenge of the situation and not by external pressures; the passion and interest – a person's internal desire to do something unique; the person's sense of challenge, or a drive to prove something no one else has been able to.

Within every individual, creativity is a function of three components:

– Expertise

– Creative Thinking Skills

– Motivation

Expertise encompasses everything that a person knows and can do in the broad domain of his or her work-knowledge and technical ability. **Creative thinking** refers to how you approach problems and solutions- the capacity to put existing ideas together in new combinations. The skill itself depends quite a bit on personality as well as on how a person thinks and works. Expertise and creative thinking are the entrepreneur's raw materials or natural resources. **Motivation** is the drive and desire to do something, an inner passion and interest. When people are intrinsically motivated, they engage in their work for the challenge and enjoyment of it.

Entrepreneurial activity depends on the process of innovation following creativity, not on creativity alone.

INNOVATION

Innovation is the process of bringing the best ideas into reality, which triggers a creative idea, which generates a series of innovative events. Innovation is the creation of new value. Innovation is the process that transforms new ideas into new value. No innovation is possible without creativity. Innovation is the process that combines ideas and knowledge into new value. Without innovation an enterprise and what it provides quickly become obsolete.

Joseph Schumpeter (1934) believes that the concept of innovation, described as the use of an invention to create a new commercial product or service, is the key force in creating new demand and thus, new wealth. Innovation creates new demand and entrepreneurs bring the innovations to the market. This destroys the existing markets and creates new ones, which will in turn be destroyed by even newer products or services. Schumpeter calls, this process, 'creative destructions'.

Principles of Innovation*

Innovation requires a fresh way of looking at things, an understanding of people, and an entrepreneurial willingness to take risks and to work hard. People involved in innovation are guided by certain principles of innovation. These vary among different entrepreneurs; organisation; philosophers; but the basic framework remains the same.

Steve Jobs has given 7 principles largely responsible for success through innovation. These are described in his book, "*The Innovation Secrets of Steve Jobs*". Briefly, these principles are as follows:

Principle One

Do what you love: Steve Jobs once told a group of employees, "People with passion can change the world for the better." Jobs has followed his heart his entire life and that passion, he says, has made all the difference. It's very difficult to come up with new, creative, and novel ideas unless you are passionate about moving society forward.

Principle Two

Put a dent in the universe: Passion fuels the rocket, but vision directs the rocket to its ultimate destination. In 1976, when Jobs and Steve Wozniak co-founded Apple, Jobs' vision was to put a computer in the hands of everyday people. In 1979, Jobs saw an early and crude graphical user interface being demonstrated at the Xerox research facility in Palo Alto, California. He knew immediately that the technology would make computers appealing to "everyday people." Xerox scientists didn't realize its potential because their "vision" was limited. Two people can see the exactly the same thing, but perceive it differently based on their vision.

Principle Three

Kick start your brain: Steve Jobs once said "Creativity is connecting things." Connecting things means seeking inspiration from other industries. At various times, Jobs has found inspiration in a phone book, Zen meditation, visiting India, a food processor at Macy's, or The Four Seasons hotel chain. Steve doesn't "steal" ideas as much as he uses ideas from other industries to inspire his own creativity.

Principle Four

Sell dreams, not products: To Steve Jobs, people who buy Apple products are not "consumers." They are people with hopes, dreams and ambitions. He builds products to help people achieve their dreams. He once said, "some people think you've got to be crazy to buy a Mac, but in that craziness we see genius." How do you see your customers? Help them unleash their inner genius and you'll win over their hearts and minds.

Principle Five

Say no to 1,000 things: Steve Jobs once said, "I'm as proud of what we don't do as I am of what we do." He is

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*www.forbes.com

committed to building products with simple, uncluttered design. And that commitment extends beyond products. From the design of the iPod to the iPad, from the packaging of Apple's products, to the functionality of the Web site, in Apple's world, innovation means eliminating the unnecessary so that the necessary may speak.

Principle Six

Create insanely great experiences: The Apple store has become the world's best retailer by introducing simple innovations any business can adopt to create deeper, more emotional connections with their customers. For example, there are no cashiers in an Apple store. There are experts, consultants, even geniuses, but no cashiers. Why? Because Apple is not in the business of moving boxes; they are in the business of enriching lives.

Principle Seven

Master the message: Steve Jobs is the world's greatest corporate storyteller, turning product launches into an art form. You can have the most innovative idea in the world, but if you can't get people excited about it, it doesn't matter. Simply put, innovation is a new way of doing things which results in positive change. Innovation is attainable by anyone at any organization, regardless of title or position. Make innovation a part of your brands' DNA by thinking differently about business challenges.

CREATIVITY AND INNOVATION IN AN ENTREPRENEURIAL ORGANIZATION

Growth and development cannot be sustained without additional innovations. Additional innovations make firms look glamorous in terms of new products, new marketing techniques, and newer ways to reach out to customer in satisfying their needs. These are usually seen as part of the process of innovation, which is itself seen as the engine driving continued growth and development. The 'winning performance' of the entrepreneur and the organization focuses on

– Competing on quality, not prices

– Domination of a market niche

– Competing in an area of strength

– Having tight financial and operating controls

– Frequent product or service innovation

Entrepreneurship is, therefore, the innovatory process involved in the creation of an economic enterprise based on a new product or service which differs significantly from products or services offered by other suppliers in content or in the way its production is organized nor in its marketing.

In today's environment where competition requires business enterprises to be distinct and meet customer needs with better or newer products and organization becomes in critical necessity. Thus, entrepreneurs and enterprises are continuously creative and innovative to remain relevant to the customers, which is the purpose of every business.

This requires to study the enviornment thoroughly and scan it from the view point of stakeholders and customers in line with the strengths, oppertunities, threats, etc; so as to bring in the picture before any entrepreneurial activity is started with.

ENVIRONMENT SCANNING

Environment Scanning is careful monitoring of an organization's internal and external environments for detecting early signs of opportunities and threats that may influence its current and future plans. Environmental scanning is a concept from business management by which businesses gather information from the environment, to better achieve a sustainable competitive advantage. To sustain competitive advantage, the company must also respond to the information gathered from environmental scanning by altering its strategies and plans when the need arises.

When entrepreneurship is taken into consideration; environment scanning is another important factor to be taken care of with regards to developing a new plan which comprises of innovative ideas and creative ends so that the same may be developed and offered in the market after a careful analysis for its possibility of acceptance, opportunity in the same, and prospective threats.

Importance of Environmental Scanning

Entrepreneurs need to carry out environmental scanning to anticipate and interpret the results that their business innovation would result in. The term environmental scanning refers to the screening of large amounts of information in order to detect emerging trends and to create a set of scenarios. Companies which scan their business environment are proven to achieve higher profits and revenue growth compared to companies which do not.

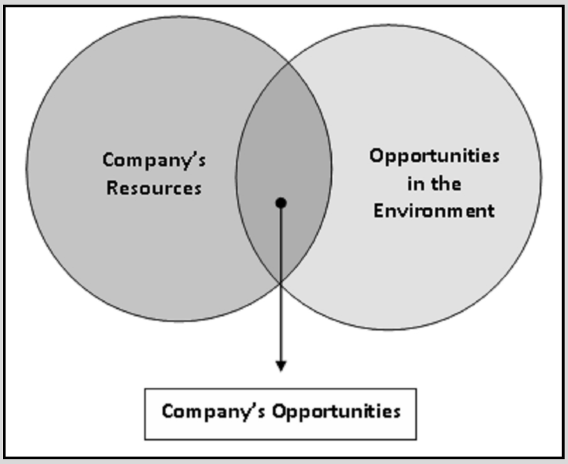
The importance of environmental scanning was first recognized by life insurance firms in the late 1970s. For instance; at that time, the demand for life insurance was declining, and the insurance firms had failed to recognize that there was a fundamental change in family structure in the U.S. Young families in the late 1970s tended to be dual-career couples and they increasingly prefer to remain childless for a longer period of time. Because the families were smaller, the demand for life insurance declined. This is one of the examples as to how scanning of environment is helpful in analyzing the factors for the behaviour of the entrepreneurial activity conducted.

There are various techniques which may be used in environment scanning namely;

- SWOT Analysis
- PEST/ PESTEL Analysis
- Industry Analysis

SWOT ANALYSIS

Originated by Albert S Humphrey in the 1960s, SWOT Analysis is as useful now as it was then. SWOT is the analysis of a company's **S**trengths, **W**eaknesses, **O**pportunities, and **T**hreats to identify a strategic niche that the company could exploit. SWOT Analysis merges the external factors (environment analysis, opportunities and threats identification) with the internal factors (company's resources analysis, company's strengths and weaknesses identification).



SWOT Analysis

SWOT analysis is very important. The entrepreneur is able to access the feasibility of his goals and objectives using the outcome of SWOT analysis and identification of the company's opportunities. The entrepreneur who has conceived an idea in his minds would then be able to evaluate whether such plans, mission and objectives are even close to realism or are in the wave of air only. If they are realistic, the entrepreneur can continue to formulate strategies. But if they are not realistic, the entrepreneur should amend and modify plans or discard the same to originate a new one which has more odds of the success.

This tool can use it in two ways - as a simple icebreaker helping entrepreneur to analyze the plan and judge the feasibility, or in a more sophisticated way as a serious strategy tool wherein the entrepreneur checks SWOT every stage of his formulating the plan and then put forward the idea as a business.

There are four components to this analysis. Strengths and weaknesses are often internal to your organization, while opportunities and threats generally relate to external factors. For this reason the SWOT Analysis is sometimes called Internal-External Analysis and the SWOT Matrix is sometimes called an IE Matrix.

All four components cover certain basic questions that need to be answered. These are as follows:

Strengths

- What advantages does your idea have?
- How does it serve the society better than anyone else?
- How do you use unique or lowest-cost resources to your idea that others can't?
- What would be your strengths in the market ones this idea is materialized?
- What factors mean that you "get the sale"?
- What is your innovation's Unique Selling Proposition (USP)?

Consider your strengths from both an internal perspective, and from the point of view of your customers and people in your prospective market.

Weaknesses

- What is the further scope of improvement?
- What are the things that need to be avoided?
- What are people in your market likely to see as weaknesses?
- What factors lose you sales?

Opportunities

- What good opportunities can you spot in relation to the innovative idea you have?
- What interesting trends are you aware of?

Useful opportunities can come from such things as

- Changes in technology and markets on both a broad and narrow scale.
- Changes in government policy related to your field.
- Changes in social patterns, population profiles, lifestyle changes, and so on.
- Local events.

Threats

- What obstacles are likely to be faced?

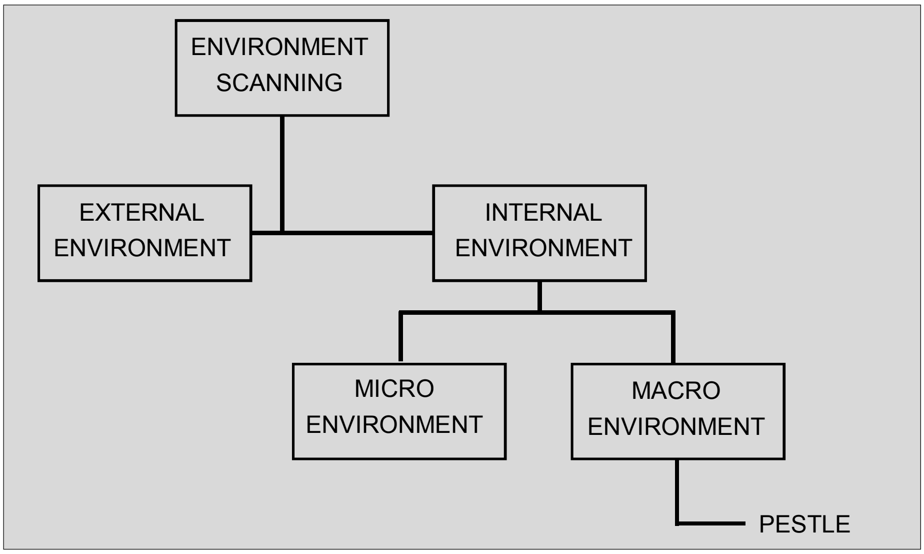
- What are your competitors doing?
- Are quality standards or specifications for your job, products or services changing?
- Is changing technology threatening your position?
- Could any of your weaknesses seriously threaten your business?

When looking at your strengths, think about them in relation to your competitors. For example, if all of your competitors provide high quality products, then a high quality production process is not strength in your organization's market, it's a necessity.

A useful approach when looking at opportunities is to look at your strengths and ask yourself whether these open up any opportunities. Alternatively, look at your weaknesses and ask yourself whether you could open up opportunities by eliminating them.

When looking at opportunities and threats, PESTLE Analysis can also help to ensure that you don't overlook external factors, such as new government regulations, or technological changes in your industry. This is another technique of environment scanning.

PESTLE ANALYSIS



PESTLE stands for - **P**olitical, **E**conomic, **S**ociological, **T**echnological, **L**egal, and **E**nvironmental. The term PESTLE has been in regular use for last 10 years.

PESTLE analysis is in fact, an audit of environmental influences on the business idea with the purpose of using this information to preascertain the factors affecting the likely project and thereby guide strategic decision-making in accordance. The assumption is that if the entrepreneur is able to audit his influencing environment and assess potential threats to his project, it will be better placed in the market, and be able to accommodate the influencing factors.

PESTLE analysis is a useful tool for understanding the 'big picture' of the environment in which an entrepreneur is planning to operate. Specifically, a PESTLE analysis is a useful tool for understanding risks associated with several forms of markets, growth or decline, and as such the position, potential and direction for an individual business or organisation. This is often used as a generic 'orientation' tool, which finds out the stand of the prospective business plan of the entrepreneur in the external environment in terms of the components so mentioned that will at some point affect the internal environment of the business ones it is set up. The six elements form a framework for reviewing a situation, and can also be used to review a strategy or position, direction of a company, a marketing proposition, or idea.

It is important to clearly identify the subject of a PESTLE analysis (that is a clear goal or output requirement), because an analysis of this type is multi faceted in relation to a particular business unit or proposition – if the focus is diluted as to what is exactly required from the technique, the picture so produced would be unclear and ambiguous.

A scan of the external macro-environment which are likely to influence the business idea can be expressed in terms of the following factors:

- Political Factors
- Economic Factors
- Social Factors
- Technological Factors
- Legal Factors
- Environmental Factors

1. POLITICAL FACTORS

- tax policy
- employment laws
- environmental regulations
- trade restrictions and tariffs
- political stability
- government type and stability
- freedom of press, rule of law and levels of bureaucracy and corruption
- regulation and de-regulation trends
- environmental and consumer-protection legislation

2. ECONOMIC FACTORS

- current and projected economic growth, inflation and interest rates
- exchange rates
- stage of business cycle
- unemployment and labor supply
- labor costs
- levels of disposable income and income distribution
- impact of globalization
- impact of technological or other change on the economy

3. SOCIAL FACTORS

- health awareness
- population growth rate

- age distribution
- career attitudes
- emphasis on safety
- population health, education and social mobility, and attitudes
- population employment patterns, job market freedom and attitudes to work
- press attitudes, public opinion, social attitudes and social taboos
- lifestyle choices and attitudes

4. TECHNOLOGICAL FACTORS

- R&D activity
- impact of emerging technologies and research & Development activity
- impact of internet, reduction in communications costs and increased remote working
- impact of technology transfer

5. LEGAL FACTORS

- licensing framework
- employment laws
- competition laws
- foreign transaction laws
- taxation laws

6. ENVIRONMENTAL FACTORS

- environmental impact
- environmental legislation
- energy available and costs
- waste disposal

This checklist of the factors is inclusive in nature. Other related aspects that have a bearing in respective factor may also be considered based on the stance of the idea that is being converted into business.

PORTER'S APPROACH TO INDUSTRY ANALYSIS

Another important tool for environment scanning is to conduct industry analysis which is to take a survey of the existing industry if any, before setting up an entrepreneurial endeavour. An entrepreneur is most concerned with the intensity of competition to which his idea is exposed. The level of this intensity may be determined by basic competitive forces. In scanning the industry, the entrepreneur must assess the importance to its success of each of the five forces.

The Porter's Five Forces tool is a simple but powerful tool to evaluate the power of business. This is useful, because it helps to understand both the strength of current competitive position, and the strength of the position moving into.

With a clear knowledge of where power lies, fair advantage can be taken in case of situation of strength, and contrarily improve a situation of weakness, and avoid taking wrong steps. This forms an important part of planning toolkit of business endeavor.

Conventionally, the tool is used to identify whether new products, services or businesses have the potential to be profitable. However it can be very illuminating when used to understand the balance of power in other situations.

Porter's Five Forces Analysis assumes that there are five important forces that determine competitive power in a business situation. These are:

(i) *Supplier Power:* This assesses how easily suppliers may drive up prices. This in lieu depends upon the number of suppliers of each key input. The uniqueness of their product or service, their strength and control over the entrepreneur's cost of switching from one to another, and so on are significant factors to measure suppliers powers. The fewer the supplier choices, and the more is the need of suppliers' help, the more powerful suppliers become.

(ii) *Buyer Power:* This evaluates how easy it is for buyers to drive prices down. Again, this is driven by the number of buyers; the demand for the new product or service. The importance of each individual buyer to business, the cost to them for accepting the new product launched, and so on are influencing factors to know how much buyers can affect the success of business plan.

(iii) *Competitive Rivalry:* What is important here is the number and capability of competitors. If there are many competitors to the new product, who offer equally attractive products and services, then the product will most likely have little power in the situation, because suppliers and buyers will have alternate choices to make in case they do not get a good deal. On the other hand, if no-one else can do what you do, then you can often have tremendous strength.

(iv) *Threat of Substitution:* This is affected by the ability of your customers to find a different way of doing what you do – for example, if you supply a unique software product that automates an important process, people may substitute by doing the process manually or by outsourcing it. If substitution is easy and substitution is viable, then this weakens your power.

(v) *Threat of New Entry:* Power is also affected by the ability of people to enter your market. If it costs little in time or money to enter your market and compete effectively, if there are few economies of scale in place, or if you have little protection for your key technologies, then new competitors can quickly enter your market and weaken your position. If you have strong and durable barriers to entry, then you can preserve a favorable position and take fair advantage of it.

Environmental Scanning Process

Environmental scanning begins with gathering information about the internal and external environments. This information can be obtained from various sources, both internal and external to the organization.

Scanning includes a broad range of activities. It is a process of screening a large body of information for some particular bit of information that meets certain screening criteria. This process has several distinct steps:

1. searching for information resources
2. selecting information resources to scan
3. identifying criteria by which to scan
4. scanning
5. determining special actions to take on the scanning results

Types of Environmental Scanning

(i) ***Passive Scanning:*** Everyone scans continually. Ongoing scanning at an almost unconscious level is passive scanning. No effort is made to select a particular information resource to scan. The criteria of passive scanning are obscure, unspecified, and often continuously changing. Only ad hoc decisions are made on the results of this type of scanning.

Passive scanning has traditionally been a major source of information about the external world for most entrepreneurs for decision making on the new product. The continuous scanning only helps them arrive at an innovative altogether new solution to business.

(ii) ***Active Scanning:*** The components of active scanning are quite different from those of passive scanning. For example, the searching or screening process requires a much higher level of attention. The information resources scanned are specifically selected for their known or expected richness in the desired information.

A dimension of scanning concerns the time element of the information source being scanned. Information sources are either already existing resources, such as “the literature,” or continuing resources, which continue to come in, such as a magazine subscription. Active scanning involves the conscious selection of continuous resources and, from time to time, supplementing them with existing resources as needed.

(iii) ***Directed Scanning:*** The active scanning of an existing resource for a specific item is directed scanning. Usually this scanning continues until the items are located, not necessarily until the resources are exhausted. As the specific desired item is known and the resource can be specified, the scanning committee can delegate whatever directed scanning is necessary.

MARKET ASSESSMENT

Whether it is about starting a new business or launching a new product, conducting a market assessment is essential to know whether there exists any demand to the idea. Knowing of the market’s needs provides with key information that is essential in further molding the idea and to develop the plan map. Too often, businesses spend thousands of dollars launching a “new” idea with a limited market because of competition. The owner is forced to reevaluate his strategy and determine if there is room for another player.

Conducting a market assessment helps to:

– Prepare to enter a new market

– Launch a new product/service

– Start a new business

The marketing assessment process can be laid down into six steps:

1. Defining the problem
2. Analysis of the situation
3. Obtaining data that is specific to the problem
4. Analysis and interpreting the data
5. Fostering ideas and problem solving
6. Designing a plan

1. Defining the Problem

Defining the problem is crucial to conducting a successful marketing analysis. This may require a great deal of time but it is well worth the time and energy employed. Defining the objectives is defining the problem which is tantamount to a successful marketing campaign. Many entrepreneurs tend to waste valuable time performing good research on the wrong problem.

2. Analyzing the Situation

An analysis of the situation is an informal survey of what information is available in the problem area. The analysis will help define the problem and ascertain the need for additional information. This process entails informal talks with informed people. Informed individuals can be others in the company or outsiders with knowledge about the industry or product. In some instances, customers are contacted to provide information.

When the marketing manager is unfamiliar with the situation, the analysis step is of primary importance. It is important to understand the problem area - including the nature of the target market, competition, the marketing mix and the external environment.

The analysis should focus on both primary and secondary research.

Primary and Secondary Market Research

Primary research is research that is proactively created for a specific purpose. Primary research may include focus groups, qualitative surveys and phone interviews.

In contrast, secondary research is research that has already been conducted for other purposes. From it valuable information can be gleaned. Secondary research can be found in libraries, online, through periodicals, books, etc.

Once all the information required is known, make sure market should be receptive to the product or service. The widget might be the most innovative on the market, but if the target market doesn't think so, it leads to nowhere zone. Thus a comprehensive primary market research study is essential.

3. Obtaining Data Specific to the Problem

The next step requires gathering primary research and performing a formal research project. Many approaches can be used to collect primary data. The purpose is for the research to identify customer's behaviour patterns in response to particular product good or any idea. Research can be done in person or through a survey. Questioning can be qualitative or quantitative. Another research option is to use observation of customers and their purchases or utilization of a product or service.

4. Data Analysis and Interpretation

Data analysis and interpretation is critical in analyzing the market. By merely conducting the research work and collating the data is of no help unless analyzed. The data needs to be used in a constructive way to define the problem and then establish a plan. In quantitative research, this step most often involves statistics. Marketing managers must be able to draw valid and solid conclusions from the conducted study. Despite use of the correct statistical tool and accurate calculations, the interpretation could be wrong. It is therefore required that the analysis be done in the support of experts and right results are crafted.

5. Fostering Ideas and Problem Solving

At this step, the research results are used to make marketing decisions. The findings should be applied in marketing planning. If the research doesn't provide the information necessary to make these decisions, the company, whether small or large, has wasted its time, money and manpower on unnecessary data. The final step must be anticipated throughout the entire process.

6. Marketing Plan

This six-step process of market analysis is critical in designing a marketing plan that is tailored to the product or service. The process can be extremely helpful in disclosing a significant but previously unrecognized problem. By finding and focusing on the real problem, the researcher and business owner can move quickly to a useful solution.

A marketing plan shows the specifics of how the entrepreneur will market or attempt to sell his product or service.

REVIEW QUESTIONS

State True or False:

1. Change is an organizational reality.

2. The marketplace is an external force of change.

Answers: 1. True 2. True

ASSESSMENT OF BUSINESS OPPORTUNITIES

Whenever business people are suggested about starting a Business Plan, they invariably have one of two replies – "We're too small to have a fancy business plan" or "We should, but we're too busy to go through the process right now". There are two basic misconceptions for business plans.

- Too much work for little or no benefit
- Business plans are for larger, fancier companies

Business Plan: The process of producing a business plan is, in itself, a beneficial undertaking. It facilitates management's focus on the future as well as the present. In the process of preparing the plan, they have a chance to step back and assess where they are now in terms marketing, production, and finances. This assessment can be cause for "pats on the back" and honesty about past errors.

Looking to the future, the process allows a business person to look out five or ten years and say, "In my dreams, this is where I want this company to be". The business plan forms the road map to get to those dreams. It gives interim targets to hit. It highlights the many challenges. It points out the company's strengths and how to capitalize on them. It does all this by forcing the business person to objectively think things through. When they think through one area, the process requires them to think through the impact on other areas of the company. For example, given sales targets, they must now consider equipment and personnel requirements to reach those targets. Next, they must realistically analyze how they can finance these necessary resources.

The most significant benefit of a business plan is in the periodic review of actual results. A manager/owner should take out the business plan on a quarterly basis and review their actual results to the forecast. In financial terms, this involves comparing actual numbers to budget numbers. In marketing, it involves comparison of unit sales, department sales, penetration of targeted markets, etc. This feedback allows the person to assess what worked, what went wrong, and proactively make changes to move toward their goals.

Business plans do not have to be fancy documents full of charts and graphs. They have to be documents useful in communicating what the business person has in mind. As such, they can take the form of a simple outline with budgets attached.

Several key areas to include are:

Goals: Obviously long term goals are necessary. Just as importantly, include interim goals that form the milestones of progress. It is critical that time lines be stated for the accomplishment of each goal.

Functional Strategies: A basic strategy in each functional area of the company will show how to accomplish the goals. A well developed marketing plan will show how to achieve the sales goals. An operating plan will show how to fill the sales orders. A financial plan will show how to pay for it all. Each of these plans can be written up as simple outlines with little integrating text. The content and thought process are what is important, not the form and complexity.

Budget and Cash Flow Projections: This is where small business people feel most intimidated. It is, however, the most important reality check on the rest of the plan. Can we pay for it? In the simplest form, analyze revenue and expense accounts under the projections of the plan. Given recent payment and collections history, extrapolate the impact on cash in the bank. This simple analysis will uncover any glaring critical financial problems well in advance.

Regular Reviews of the goals, objectives, and interim targets bring everyone back in focus with what they are trying to accomplish. It provides a point of reflection. It redirects actions that have strayed. It facilitates proactive management of the chaos, rather than allowing the chaos to manage the company.

Business plans are for small companies as well as large. The small company can benefit from even a simple plan that is prepared in earnest. To facilitate completing the plan, an objective third party can effectively guide a business through the process. Thus, the company gets the benefits without the administrative burden. In the end, planning to open for business tomorrow is a plan. A good business plan just takes that process to a higher, more useful level.

There are a few things to be kept in mind for initializing the business venture. First, there is no such thing called short cut. There is no easy way to success, security, independence, money whatever the case may be. Any entrepreneurial venture requires a great deal of hard work, patience, dedication, passion etc. looking for a short cut would imply offering oneself to others to take upon the opportunities that knocked your door. (That’s their opportunity niche).

Second, recognize the business opportunities and start with customer, not with know-how, not with the “bright” idea. As an inventor-entrepreneur, the best approach to make the creative innovative business idea a success is to find someone who’ll pay for the development of something they need and also let the entrepreneur keep the right to sell it to others.

Third, the essential resources for exploiting opportunities are the fundamental business skills. Given these skills, all else flows automatically. And so closely is true for vice versa; without the skills, all the attempted ventures are doomed to fail. These skills are in the form of people; which is the essence of business. A single man army is no more real. Business requires a set of people who are equally good in the other skills.

There are four skills necessary to successful business.

- Engineering Skills- the skill to invent, create, innovate and develop new products (or services).
- Manufacturing Skills- the skill to deliver them, consistently and reliably, with quality, service, and price.
- Selling Skills- the skill to sell them.
- Business Skills- the skill to make a profit doing the above three.

The skills necessary to start a business are Engineering and Selling. The skills of Manufacturing and Business determine, more, how long one stays in business. The level of quality needed in these skills is determined by the level at which one wishes to compete.

The fourth part of preparing for opportunities, is preparing the entrepreneur. Set some goals. Build a productive and a proactive approach.

Don't get trapped in false notions as to say that all the information comes from education and experience. There is a blinder appended to all the knowledge. The set of information that is acquired all this long is the solution to yesterday's problem and may not efficiently apply to those of today and further less likely to fit in for those of tomorrows; unless a good deal of creativity resulting innovation is applied.

The final part of preparing for opportunities is to quit preparing and start to act. Plans are best executed than just laying them down on paper leaves.

DEVELOPING EFFECTIVE BUSINESS PLANS

The process of starting a new venture is embodied in the entrepreneurial process, which involves more than just problem solving in a typical management position. An entrepreneur must find, evaluate, and develop an opportunity by overcoming the forces that resist the creation of something new.

The process has four distinct phases:

– identification and evaluation of the opportunity

– development of the business plan

– determination of the required resources

– management of the resulting enterprise

Identify and Evaluate the Opportunity

Opportunity identification and evaluation is a very difficult task yet very primary. Most good business opportunities do not suddenly appear, but rather result from an entrepreneur's alertness to possibilities, or in some case, the establishment of mechanisms that identify potential opportunities. For example, one entrepreneur surveys the possibility of developing a new product. This person is constantly looking for a need and an opportunity to create a better product. Another entrepreneur may be monitoring the activities or habits of the target customers, some others may be indulged in experiments of sample product. This is the way of looking for any unique product niche for a new venture. Although most entrepreneurs do not have formal mechanisms or identifying business opportunities, some sources are often fruitful: consumers and business associates, members of the distribution system, and technical people. Often, consumers are the best source of ideas for a new venture. Many a times it is observed that consumers know what they want; they do not know how to produce that. This survey can result in the creation of new business. One entrepreneur's evaluation of why so many business executives were complaining about the lack of good technical writing and word-processing services resulted in the creation of her own business venture to fill this need. Her technical writing service grew to 10 employees in two years. Due to their close contact with the end user, channel members in the distribution system also see product needs.

One entrepreneur started a college bookstore from the observation of all the students complain about the high cost of books and the lack of service provided by the only bookstore on campus. Many other entrepreneurs have identified business opportunities through a discussion with a retailer, wholesaler, or manufacturer's representative.

Finally, technically oriented individuals often conceptualize business opportunities when working on other projects.

The most famous example is of Steve Wozniak - Apple Computers

Steve got interested in science and technology around 4th grade after reading a book about this young guy who was an engineer who could design anything, and he owned his own company, and he would entrap aliens, and build submarines, and have projects all over the world. Steve would later create the first personal computer in

1977. Jobs had a passionate belief in bringing computer technology to everyone. So in 1977, Jobs and Wozniak started a company to build and distribute their invention. In true American-dream fashion, their company began in a garage. To finance their venture, Jobs sold his Volkswagen van and Wozniak sold his programmable calculator to raise $1,300. Weeks later, Jobs secured the company's first sale: 50 Apple I computers at $666 each. In a mere six years, Apple was listed in the Fortune 500, becoming the youngest firm on this prestigious list.

Whether the opportunity is identified by using input from consumers, business associates, channel members, or technical people, each opportunity must be carefully screened and evaluated. This evaluation of the opportunity is perhaps the most critical element of the entrepreneurial process, as it allows the entrepreneur to assess whether the specific product or service has the returns needed compared to the resources required. This evaluation process involves looking at the length of the opportunity, its real and perceived value, its risks and returns, its fit with the personal skills and goals of the entrepreneur, and its uniqueness or differential advantage in its competitive environment.

The market size and the length of the window of opportunity are the primary basis for determining the risks and rewards. These risks reflect the market, competition, technology, and amount of capital involved. The amount of capital needed provides the basis for the return and rewards. The methodology for evaluating risks and rewards frequently indicates that an opportunity offers neither a financial nor a personal reward commensurate with the risks involved.

Finally, the opportunity must fit the personal skills and goals of the entrepreneur. It is particularly important that the entrepreneur be able to put forth the necessary time and effort required to make the venture succeed. Although many entrepreneurs feel that the desire can be developed along the venture, typically it does not materialize. An entrepreneur must believe in the opportunity so much that he or she will make the necessary sacrifices to develop the opportunity and manage the resulting organization.

Opportunity analysis, or what is frequently called an opportunity assessment plan, is one method for evaluating an opportunity. It is not a business plan. Compared to a business plan, it should be shorter; focus on the opportunity, not the entire venture; and provide the basis for making the decision of whether or not to act on the opportunity.

An opportunity assessment plan includes the following:

- a description of the product or service
- an assessment of the opportunity
- an assessment of the entrepreneur and the team
- specifications of all the activities and resources needed to translate the opportunity into a viable business venture
- the source of capital to finance the initial venture as well as its growth

Developing a Business Plan

A good business plan must be developed in order to exploit the defined opportunity. This is a very time-consuming phase of the entrepreneurial process. An entrepreneur usually has not prepared a business plan before and does not have the resources available to do a good job. A good business plan is essential to developing the opportunity and determining the resources required, obtaining those resources, and successfully managing the resulting venture.

Effective business planning is critical to an entrepreneurial company's long-term success and its ability to raise capital and grow successfully. Business planning is the process of setting goals, explaining the objectives and then mapping out a document to achieve these goals and objectives. A well-written Business Plan lays out the best growth path and strategy, as well as the rationale for the selection of the strategy over other alternatives. In essence, a Business Plan is the articulation and explanation of why the chosen game plan for building the company makes sense, what resources it will need to implement the vision, who will be the appropriate team that will have the skills and leadership to execute the vision, and what path they will follow to get there.

Nobody has a crystal ball to predict what will work and what won't, not even a savvy investor or veteran entrepreneur. The better the analysis, the better the chances that most of the goals set forth in the business plan will be achieved. It is essentially an articulation of the entrepreneurial company's plan for managing the risks and challenges involved in building or expanding the business. As such, it should acknowledge that growth and success are moving targets by anticipating as many future events or circumstances that will affect the company's objectives.

In developing a Business Plan and a Business Model, entrepreneurs are generally found apprehensive of myths and misconceptions about the process. These myths need to be aware of and the realities be known in well before conceiving a wrong plan. Among these the most common are the following:

1. Business plans are only for start-up companies

Reality: Companies at all stages of development need to prepare Business Plans either for the planning and financing of a specific project, general expansion financing, mergers or acquisitions, and the overall improvement of the company's financial and managerial performance. A company operating for 15 years or more will need to draft a Business Plan in order to raise the necessary capital to reach the next stage in its development.

2. Business plans should be as detailed as possible; the longer the plan, the better chance that the company will be financed

Reality: The plan must be concise, well-written and should focus on the lender's or investor's principal areas of concern, and not be cluttered with lots of exhibits or irrelevant market studies. Investors only look at relevant details. Although a Business Plan ought to be presented professionally, a very expensive binder or overly lavish presentation will often demonstrate inefficient resource management.

3. Business plans should emphasize ideas and concepts, not people

Reality: Financiers and venture capitalists prefer to invest in a company that has great people and only a good concept, rather than one with a great concept and a weak management team.

4. Only the founding entrepreneur should prepare business plans

Reality: this myth has no grounds since a business plan is as technical aspect as the business itself. Thus it should be developed by a team of managers within the company and then reviewed by qualified experts, such as accountants, attorneys and the board of directors.

5. Optimism should prevail over realism

Reality: The Business Plan should demonstrate the enthusiasm of the founders of the company as well as generate excitement in the reader; however, it should be credible and accurate. Investors will want to know all of the company's strengths and its weaknesses. In fact, a realistic discussion of the company's problems, along with a reasonable plan for dealing and mitigating these various risks and challenges, will have a much more positive impact on the prospective investor. Unrealistic or unsubstantiated financial projections and budgets will reveal inexperience or lack of attention to detail, or even lead to litigation by disgruntled investors if there are wide disparities between what was represented and reality.

Determine the Resources Required

The resources needed for addressing the opportunity must also be determined. This process starts with an appraisal of the entrepreneur's present resources. Any resources that are critical need to be differentiated from those that are just helpful. Care must be taken not to underestimate the amount of variety of resources needed. The downside risks associated with insufficient or inappropriate resources should also be assessed.

An entrepreneur should strive to maintain as large an ownership position as possible, particularly in the start-up stage. As the business develops, more funds will probably be needed to finance the growth of the venture, requiring more ownership to be relinquished. Alternative suppliers of these resources, along with their needs and desires, need to be identified. By understanding resource supplier needs, the entrepreneur can structure a deal that enables the recourses to be acquired at the lowest possible cost and the least loss of control.

Manage the Enterprise

After resources are acquired, the entrepreneur must use them to implement the business plan. The operational problems of the growing enterprise must also be examined. This involves implementing a management style and structure, as well as determining the key variables for success. A control system must be established, so that any problem areas can be quickly identified and resolved. Some entrepreneurs have difficulty managing and growing the venture they created.

ENTREPRENEURIAL MOTIVATION

Meaning and Concept

It is often said that a person cannot win a game that they do not play. In the context of entrepreneurship, this statement suggests that success depends on people's willingness to become entrepreneurs. The pursuit of entrepreneurial opportunity is an evolutionary process which includes to discover the opportunity, deciding whether that is a positive one; to pursue resources, and to design the mechanisms of exploitation. Human motivations influence the decisions related to entrepreneurship endeavours, and that variance across people in these motivations will influence who pursues entrepreneurial opportunities, who assembles resources, and how people undertake the entrepreneurial process.

It should be noted that the word 'motivation' has its origin in the Latin word 'movere,' meaning "to move." Psychologically, it means an inner or environmental stimulus to action, forces or the factors that are responsible for initiation, sustaining behaviour. Motivations may be diverse, multiple and dynamic.

Need of Entrepreneurial Motivation

In common perception, entrepreneurs are after money and they engage in profit making. True, profit- as understood in terms of the residual income of the owner after meeting all the expenses incurred on the engagement and utilization of other factors of production-is the reward of entrepreneurship just as salary is to people in employment and professional fees is to those in profession. So everybody works for money. But people certainly don't work for money alone. After all, money is required not for its own sake, but for the sake of the needs of the person that it can fulfill. Money, thus, is not the need as such. It is teleological (to put it more simply, distantly) related to the internally felt needs (such as need for food) and socially acquired needs (such as status symbols).This leads to the need of entrepreneurial motivation to achieve that extra edge over others. Inner push of self motivation is required to achieve that mark.

The motivation is not a package in itself, it is accompanied by various other things which are as follows:

(i) *Self Efficacy:* According to Albert Bandura, self-efficacy is "the belief in one's capabilities to organize and execute the courses of action required to manage prospective situations". In other words, self-efficacy is a person's belief in his or her ability to succeed in a particular situation.

Virtually all people are known of the goals to accomplish, and things that need changes in the process.

However, most people also realize that putting these plans into action is not quite so simple. Bandura and others have found that an individual's self-efficacy plays a major role in how goals, tasks, and challenges are approached.

People with a strong sense of self-efficacy:

- View challenging problems as tasks to be mastered.
- Develop deeper interest in the activities in which they participate.
- Form a stronger sense of commitment to their interests and activities.
- Recover quickly from setbacks and disappointments.

People with a weak sense of self-efficacy:

- Avoid challenging tasks.
- Believe that difficult tasks and situations are beyond their capabilities.
- Focus on personal failings and negative outcomes.
- Quickly lose confidence in personal abilities.

(ii) *Creativity:* In a very simple and straightforward manner, creativity is the ability of creation, that is the causing of a new thing to exist. A thing that did not exist before now does. That thing can be anything; maybe a concept like Marginal Utility that helps to explain previously unexplained phenomena.

It could also be a product, like Champaign, wine that is fermented in a special way. A new advertising campaign is certainly an act of creation.

But things may be created if they are looked at in a different way. Creativity is also the bringing of these new perspectives. There are many ways for a creative mind to apply its talents.

- Creating a new product for which the entrepreneur has anticipated future sales.
- Improving a product, that is adding or modifying something that makes the product better according to certain criteria like consumers needs.
- Painting, writing, sculpting.
- Improving a process for manufacturing something, maybe baking a cake at home or producing a better computer application to avoid popup ads.
- Using the same product to satisfy a different need.
- Inventing new concepts or constructs that help to better explain certain phenomena, like defining an entrepreneur as a solver of market dis-equilibrium…or as a smasher of equilibrium in the economy.
- Developing a new statistical formula.
- Interpreting information in a different way.
- And yes, doing business abroad.

Creativity is a most welcomed attribute of a business plan analysis, especially when explaining the product or service to be marketed in terms of its competitive advantages. But remember that creativity is also badly needed when analyzing data. Data remains as data until someone interprets it, then it becomes information with meaning.

(iii) *Risk Taking:* The market order tends to generate goods and services to cater to the demands of the customer. More precisely, individual producers and sellers produce the goods and services, acting on the basis of their appraisal of the wants of the customers. If they are correct in their judgement then they will prosper, if not, they will not attract buyers and they will fail.

Within a free market order, entrepreneurs have to take risks because the last word lies with the potential buyers, the consumers. Ludwig von Mises pointed out in *The Anti-Capitalistic Mentality*, Illinios (1972), "In the market of a capitalistic society the common man is the sovereign consumer whose buying or abstention from buying ultimately determines what should be produced and in what quantity and quality". This involves an element of risk for the entrepreneur and in return for the risk he demands a reward —this is the profit margin. Profits serve the dual purpose of rewarding the successful entrepreneur (that is, the person who caters best to the wants of the public) and providing capital to develop the business. This may take the form of investment in updated plant for increased efficiency and lower prices, it may involve expansion into new products and new markets, and it may involve the takeover of less thriving firms in order to put their resources to more productive use.

(iv) *Leadership:* Entrepreneurship is a special skill set. Some great entrepreneurs are not-so-great leaders or managers, but successful leaders need to master some of the entrepreneurship skill set. There is a "new" word that is thrown around – Intrapreneurship – to represent the entrepreneurial activities internal to an organization. The businesses would be better off if leaders learn and adapt a bit of entrepreneurial focus as a part of being successful and enduring in business.

(v) *Entrepreneur Communication:* Early stage and start-up businesses have demanding communication challenges.

The entrepreneur must distill a lengthy business plan and its financial projections into a standard and very brief "elevator pitch"-the succinct yet complete description of the enterprise and its business model that can be communicated in the time it takes to ride an elevator to a building's top floor.And for its customers, an early-stage business needs a precisely articulated and easily communicated value proposition, or it won't generate the revenue and profits to provide the return that investors expect.

CONCLUSION

Successful entrepreneurs require an edge derived from some combination of a creative idea and a superior capacity for execution. The entrepreneur's creativity may involve an innovation product or a process that changes the existing order. Or entrepreneur may have a unique insight about the consequence of an external change. Entrepreneurship is the vehicle that drives creativity and innovation. Innovation creates new demand and entrepreneurship brings the innovation to the market. Innovation is the successful development of competitive edge and as such, is the key to entrepreneurship. Creativity and Innovation are at the heart of the spirit of enterprise. It means striving to perform activities differently or to perform different activities to enable the entrepreneur deliver a unique mix of value. Thus the value of creativity and innovation is to provide a gateway for astute entrepreneurship. This results in actively searching for opportunities to do new things, to do existing things in extraordinary ways. Creativity and Innovation therefore, trigger and propel first-rate entrepreneurship in steering organization activities in whatever new directions are dictated by market conditions and customer preferences, thereby delighting the customers to the benefit of the stakeholders. Innovation also means anticipating the needs of the market, offering additional quality or services, organization efficiently, mastering details, and keeping cost under control.

LESSON ROUND UP

- No entrepreneur or enterprise, however successful and big, can continue to hold a place of leadership unless it recognizes that modern business operates in a world of galloping change which creates new problems, risk and opportunities and for which they have to mobilize the enterprise's resources before changes make their impact felt.
- Creativity is marked by the ability to create, bring into existence, to invent into a new form, to produce through imaginative skill, to make to bring into existence something new.
- Within every individual, creativity is a function of three components:
  - Expertise
  - Creative Thinking Skills
  - Motivation
- Expertise encompasses everything that a person knows and can do in the broad domain of his or her work- knowledge and technical ability. Creative thinking refers to how you approach problems and solutions- the capacity to put existing ideas together in new combinations.
- Motivation is the drive and desire to do something, an inner passion and interest.
- Innovation is the process of bringing the best ideas into reality, which triggers a creative idea, which generates a series of innovative events. Joseph Schumpeter believes that the concept of innovation is process of "creative destructions." Innovation requires a fresh way of looking at things, an understanding of people, and an entrepreneurial willingness to take risks and to work hard.
- Steve Jobs has given 7 principles largely responsible for success through innovation. These are described in his book, "The Innovation Secrets of Steve Jobs".
  - Principle One: Do what you love
  - Principle Two: Put a dent in the universe
  - Principle Three: Kick start your brain
  - Principle Four: Sell dreams, not products
  - Principle Five: Say no to 1,000 things
  - Principle Six: Create insanely great experiences
  - Principle Seven: Master the message
- Entrepreneurship is, therefore, the innovatory process involved in the creation of an economic enterprise based on a new product or service which differs significantly from products or services offered by other suppliers in content or in the way its production is organized nor in its marketing.
- Environmental scanning is a concept from business management by which businesses gather information from the environment, to better achieve a sustainable competitive advantage.
- There are various techniques which may be used in environment scanning namely;
  - SWOT Analysis
  - PEST/ PESTEL Analysis
  - Industry Analysis

- Environmental Scanning Process
  - searching for information resources
  - selecting information resources to scan
  - identifying criteria by which to scan
  - scanning
  - determining special actions to take on the scanning results
- Environmental Scanning Types
  - Passive Scanning
  - Active Scanning
  - Directed Scanning
  - The marketing assessment process can be laid down into six steps:
  - Defining the problem is crucial to conducting a successful marketing analysis.
  - An analysis of the situation is an informal survey of what information is available in the problem area.
  - The next step requires gathering primary research and performing a formal research project
  - Data analysis and interpretation is critical in analyzing the market. By merely conducting the research work and collating the data is of no help unless analyzed.
  - The findings should be applied in marketing planning
  - This six-step process of market analysis is critical in designing a marketing plan that is tailored to the product or service. A marketing plan shows the specifics of how the entrepreneur will market or attempt to sell his product or service.
- The process has four distinct phases:
  - identification and evaluation of the opportunity
  - development of the business plan
  - determination of the required resources
  - management of the resulting enterprise

GLOSSARY

Creative Destructions The act of a newly created thing destroying its predecessors. This is a common occurrence in business processes that thrive on innovation to keep their businesses successful. The term was coined by Joseph Schumpeter in his work entitled "Capitalism, Socialism and Democracy".

Environment Scanning Careful monitoring of an organization's internal and external environments for detecting early signs of opportunities and threats that may influence its current and future plans.

SWOT Analysis SWOT is an acronym for Strengths, Weaknesses, Opportunities and Threats. By definition, Strengths (S) and Weaknesses (W) are considered to be internal factors

	over which you have some measure of control. Also, by definition, Opportunities (O) and Threats (T) are considered to be external factors over which you have essentially no control.
PEST/ PESTEL Analysis	PESTLE is an analytical tool which considers external factors and helps to evaluate their impacts on the internal business.
Passive Scanning	Ongoing scanning at an almost unconscious level is passive scanning.
Active Scanning	Active scanning involves the conscious selection of continuous resources and, from time to time, supplementing them with existing resources as needed.
Directed Scanning	The active scanning of an existing resource for a specific item is directed scanning.
Primary Research	Research which is proactively created for a specific purpose.
Secondary Research	Research which has already been conducted for other purposes and is re organized for specific purpose.

SELF-TEST QUESTIONS

1. How would you relate Creative Thinking to entrepreneurship?
2. "Sell dreams, not products". Justify the statement in one or two lines.
3. Write down all the factors which lead to a winning performance of an entrepreneur.
4. What have you understood about environmental scanning? Name the techniques for environmental scanning.
5. Which approach is used to identify as to which product/tool shall be profitable to business? Write something about this approach.
6. Write very briefly about all the important forces that determine competitive power in a business situated.
7. "This process of scanning continues until the items are located, not necessarily until resources are exhausted". Which is the process which is being discussed here? Write a line about the same.
8. What is the step at which research results are used to make marketing decisions? What happens if the research does not provide the necessary information?
9. What four skills are necessary for a successful business?
10. "To exploit a defined opportunity is in itself a task." As an entrepreneur how would deal with such a problem?
11. "Once a business has been established, a business plan is not required as it is meant only for startup companies". Critically evaluate.
12. Define an entrepreneurial motivation.
13. What is it that that you lack (as an entrepreneur) when you believe that difficult tasks are beyond their capabilities? Write other points which take place due to the lack of this quality.
14. Define creativity.

Suggested Readings

(i) P. Nagendra Singh- Emerging Trends in Entrepreneurship Development

Lesson 15
Growth & Challenges of Entrepreneurial Venture

LESSON OUTLINE

- Nature of Planning in Emerging Firms
- Formal and Systematic Business Planning
  - Strategic Planning
  - Operational Planning
- Entrepreneurial Opportunities
  - Future of Entrepreneurship
  - Supply of Entrepreneurship and Economic Development
  - Creating Indian Entrepreneurs
  - Challenges before Entrepreneur
- Financing Entrepreneurial Business
- Growth and Challenges of Entrepreneurship
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

A decision to start up an entrepreneurial venture involves various crucial decisions like choice between own business and present career, apart from the decision that both external and internal factors make new venture creation possible.

A whole new set of challenges crop up when it comes to starting up a venture where as, a whole new set of challenges crop up when it comes to growth of business.

The desirability of starting one's own company is strongly influenced by factors such as culture, sub-culture, family, teachers, and peers. These may function as a source of encouragement for entrepreneurship and vice versa. Every business moves through several stages of growth and faced challenges during that growth. Nothing can be static. It is infact said that without change; some form of development completely dies.

Sometimes, it is required to not 'reinvent' the wheel but to just have the willingness to learn from what is already been presented to you by others.

The objective of the lesson is to brief on the entrepreneurial strategies which involves planning, opportunities and challenges.

Our business in life is not to get ahead of others, but to get ahead of ourselves — to break our own records, to outstrip our yesterday by our today.

Stewart B. Johnson

NATURE OF PLANNING IN EMERGING FIRMS

The main objective of business planning is to provide and implement the formal and systematic business plan. The objective of formal business plan is to be in the circle of contemporary business standard formality and the requirements in the region where business is operating. The objective of systematic is the effectiveness of business plan to excel in reality, exercised or practiced by entrepreneurs.

Business plan's formality and systematic does exhibits many strengths and opportunities in entrepreneur venture. Therefore, the venture growing with right inclination/development steps/stages from the Seed, Start up, Early growth, Established, and Corporate.

STAGE OF DEVELOPMENT IN ENTREPRENEURIAL FIRM

Seed-stage

▼

Start up

▼

Early growth

▼

Established

▼

Corporate

Formal and systematic business planning must includes these type of elements:

1. Strategic Planning

2. Operational Planning

What is Strategic Planning?

Strategic plan formulate the effective management concentrates on opportunities and threats in long- range plans. It defined the venture's specific, measurable, achievable, reachable, time frame, exciting, and rewarding to the respective future business direction.

Strategic plan draws the clear layout of the specific business's venture; vision, missions, objectives, competencies, managerial abilities, technical proficiencies, and sources of fund.

Strategic planning includes strategic management which implemented the following strategic processes; Environmental scanning, strategy formulation, strategy implementation, and evaluation and control.

Environment scanning applies to both; external and internal; scanning processes. External environmental scanning accounts the social environment (general forces) and task environment (industry analysis). The internal environmental scanning includes structure (chain of command), culture (beliefs, expectations, values), and resources (assets, skills, competencies, knowledge).

Strategy formulation is a detailing process in the mission (reason for existence), objectives (what results to accomplish by when), strategies (plan to achieve the mission and objectives), and policies (broad guidelines for decision making).

Strategy implementation is the process of conducting programs (activities needed to accomplish a plan), budgets (cost of the programs), and procedures (sequence of steps needed to do the job)

Evaluation and control is to determine the performance which is a process to monitor performance and take corrective action. It also revises the procedure in strategy implementation.

What is Operational Planning?

Operational planning defines how to operate in practice to implement action and monitoring plans what are capacity needs, how resources are to be used, how risks are to be dealt with and how sustainability of the project's achivement is ensured.

An Operational planning does not exist as one single standalone plan, rather the key components are integrated with the other parts of the overall strategic plan. Well implemented strategic planning provides the vision, direction and goals for the organization, but operational planning translates that strategy into the everyday execution tactics of the business that will ultimately produce the outcomes defined by the strategy.

Simply stated, Operational planning is the conversion of strategic goals into managed executions.

The critical role operational planning plays in strategic execution: Corporate strategy can be thought of a message packet that must be passed through the organization, understood by all and acted upon in orchestration. If the message is garbled, ambiguous or not communicated well, the intent will be lost in translation and operational execution will become misaligned with the corporate strategic goals.

Superior operational planning requires proactive thinking to enact strategy within the operational layer of the business. Operational planning must produce the plan outcomes while managing constraints on time, money and resources.

ENTREPRENEURIAL OPPORTUNITIES

Increasingly open markets, a shift to service-driven economies and concerns about employment are now the backdrop to discussions as to how governments, enterprises, and labour policy specialists respond in the bid to meet competition. Central to the debate is the role and contribution of education systems in promoting productivity and sustainable economic growth, and in particular the quality of education through-out, increasingly considered essential to equip economies to head off the challenge in the global market place.

Future of Entrepreneurship

Both, the Central Government and various State Governments are taking increased interest in promoting the growth of entrepreneurship. Individuals are being encouraged to form new businesses and are being provided such government support as tax incentives, buildings, roads, and a communication system to facilitate this creation process. The encouragement by the central and state governments should continue in future as more lawmakers are realizing that new enterprises create jobs and increase the economic output of the region. Every state government should develop its own innovative industrial strategies for fostering entrepreneurial activity and timely development of the technology of the area. The states should have their own state-sponsored venture funds, where a percentage of the funds has to be invested in the ventures of the states.

Society's support of entrepreneurship should also continue. This support is critical in providing both motivation and public support. A major factor in the development of this societal approval is the media. The media should play a powerful and constructive role by reporting on the general entrepreneurial spirit in the country highlighting specific success cases of this spirit in operation.

Finally, large companies should show an interest in their special form of entrepreneurship-intrapreneurship-in the future. These companies will be increasingly interested in capitalizing on their Research & Development in the hyper competitive business environment today.

Supply of Entrepreneurship and Economic Development

British economists such as Adam Smith, David Ricardo, and John Stuart Mill, briefly touched upon the concept of entrepreneurship, though they referred to it under the broad English term “business management”. Whereas the writings of Smith and Ricardo suggest that they undervalued the importance of entrepreneurship, Mill goes out of his way to stress the significance of entrepreneurship for economic growth. In his writings, Mill claims that entrepreneurship requires ‘no ordinary skill’, and he laments the fact that there is no good English equivalent word to encompass the specific meaning of the French term ‘entrepreneur’.

The necessity of entrepreneurship for production was first formally recognized by Alfred Marshall in 1890. In his famous treatise Principles of Economics, Marshall asserts that there re four factors of production: land, labour, capital and organization. Organization is the coordinating factor, which brings the other factors together, and Marshall believed that entrepreneurship is driving element behind organization. By creatively organizing, entrepreneurs create new commodities or improve “the plan of producing an old commodity”. In order to do this, Marshall believed that entrepreneurs must have a thorough understanding about their industries, and they must be natural leaders. Additionally, Marshall’s entrepreneurs must have the ability to foresee changes in supply and demand and be willing to act on such risky forecasts in the absence of complete information.

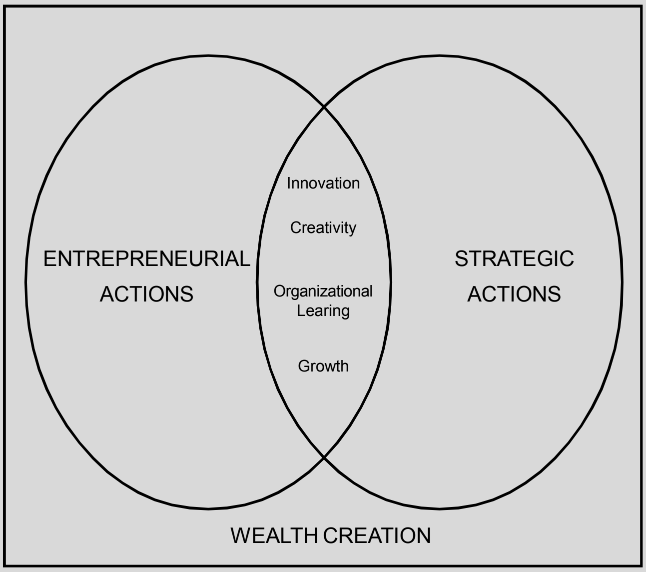
Marshall also suggests that the skills associated with entrepreneurship are rare and limited in supply. He claims that the abilities of entrepreneur are “so great and so numerous that very few people can exhibit them in all in a very high degree”. Marshall, however, implies that people can be taught to acquire the abilities that are necessary to be an entrepreneur. Unfortunately, the opportunities for entrepreneurs are often limited by economic environment, which surrounds them. Additionally, although entrepreneurs share some common abilities, all entrepreneurs are different, and their success depend on the economic situations in which they attempt their endeavors.

One school of thought on entrepreneurship suggests that role of the entrepreneur is that of a risk-bearer in the face of uncertainty and imperfect information. Knight claims that an entrepreneur will be able to bear the risk of a new venture if he believes that there is a significant chance of profits. Although many current theories on entrepreneurship agree that there is an inherent component of risk, the risk-bearer theory alone cannot explain why some individuals become entrepreneurs while others do not. Thus, in order to build a development model of entrepreneurship it is necessary to look at some of the other characteristics that help explain why some people are entrepreneurs; risk may be a factor, but it is not the only one.

Modern school of thought claims that the role of the entrepreneur is that of an innovator; however, the definition of innovation is still widely debatable. Kirzner suggests that the process of innovation is actually of spontaneous “undeliberate learning”. Thus, the necessary characteristics of the entrepreneur is alertness, and no intrinsic skills-other than that of recognizing opportunities-are necessary. Other school of economists claims that entrepreneurs have special skills that enable them to participate in the process of innovation. Leibenstein claims that the dominant, necessary characteristics of entrepreneurs is that they are gap-fillers i.e. they have the ability to perceive where market fails and to develop new goods or processes that he market demands but which are not currently being supplied. Thus, entrepreneurs have the special ability to connect different markets and make up for market failures and deficiencies.

Though the idea that entrepreneurs are innovators is largely acceptable, it can be difficult to apply this theory of entrepreneurship to less developed countries (LDCs). Often in LDCs, entrepreneurs are not truly innovators in the traditional sense of the word. Entrepreneurs in LDCs rarely produce brand new products: rather they imitate the products and production processes that have been invented elsewhere in the world (typically in developed countries). This process, which occurs in developed countries as well, is called "creative imitation". Creative imitation takes place when imitators better understand how an innovation can be applied, used, or sold in their particular market niche (namely their own countries) than do the people who actually created or discovered the original innovation. Thus, the innovation process in LDCs is often that of imitating and adapting, instead of traditional notion of new product or process discovery and development.

By combining the above thoughts it can be generalized that entrepreneurs are risk-bearers, coordinators and organizers, gap fillers, leaders, and innovators or creative imitators. Thus, by encouraging these qualities and abilities, governments can theoretically alter their country's supply of domestic entrepreneurship.



Entrepreneurial Opportunities

Basic Types of Entrepreneurship

Apparently, it can be said that the starting point of entrepreneurship would define its type. The two types of entrepreneurship may be classified as:

(i) *Opportunity-Based Entrepreneurship*: An entrepreneur perceives a business opportunity and chooses to pursue this as an active career choice.

(ii) *Necessity-Based Entrepreneurship*: An entrepreneur is left with no other viable option to earn a living. It is not the choice but compulsion, which makes him/her, choose entrepreneurship as a career.

Creating Indian Entrepreneurs

Today's knowledge based economy is fertile ground for entrepreneurs, in India. It is rightly believed that India has an extraordinary talent pool with virtually limitless potential to become entrepreneurs. Therefore, it is important to get committed to creating the right environment to develop successful entrepreneurs. To achieve this, India must focus on four areas.

(i) *Create the Right Environment for Success:* Entrepreneurs should find it easy to start a business. To do so, most Indians would start slow with capital borrowed from family and friends, the CEO playing the role of salesman and strategist, a professional team assembled months or perhaps years after the business was created, and few, if any, external partners. Compare this with a start-up in Silicon Valley: a Venire Capitalist (VC) or angel investor would be brought in early on; a professional management team would drive the business; a multifunctional team would be assembled quickly; and partnerships would be explored early on to scale up the business. A major challenge for India is to create a handful of areas of excellence- the breeding ground where ideas grow into businesses. Fr example, Gurgaon and Hyderabad for remote services, or Bangalore for IT. One way of strengthening these areas is to consider the role of universities and educational institutions-places where excellence typically thrives.

(ii) *Ensure that Entrepreneurs have access to the Right Skill:* A survey conducted by McKinsey & Company last year revealed that most Indian start-up businesses face two skill gaps: entrepreneurial (how to manage business risks, build a team, identify an get funding) and functional (product development know-how, marketing skills, etc.) India can move toward ensuring that the curriculum at universities is modified to address today's changing business landscape, particularly in emerging markets, and to build 'centres of entrepreneurial excellence' in institutes that will actively assist entrepreneurs.

(iii) *Ensure that Entrepreneurs have access to 'Smart Capital':* For a long time, Indian entrepreneurs have had little access to capital. It is true that in the last few years, several Venture Funds have entered the Indian Market. And, while the sector is still in infancy in India (with estimated total disbursement of less than US$0.5 billion in the year 2003), VCs are providing capital as well as critical knowledge and access to potential partners, suppliers, and clients across the globe. However, India has only a few angel investors who support the idea in the early stages before VCs become involved. While associations such as TIE are seeking to bridge the gap by working at creating a TIE India Angel Forum, this is India's third challenge creating a global support network of 'angels' willing to support young business.

(iv) *Enable Networking and Exchange:* Entrepreneurs learn from experience-theirs and that of others. The rapid pace of globalization and fast growth of Asian economies present tremendous opportunities and challenges for India. Through planning and focus, India can aspire to create a pool of entrepreneurs who will be the region's –and the world's-leaders of tomorrow.

Developing an entrepreneur depends largely on the thought process. The mind set of people has a significant role to play in cropping up of an idea and thereafter bringing it to market and selling it.

There are mainly two mindsets, that of 'employee' and that of 'entrepreneur.' Bear in mind that the discussion is on the way people think, not what they are doing.

An employee is used to thinking of value in terms of time and effort. For instance, if an employee takes an hour to create a tool or device, he would sell his creation for the value of the hour he spent making it, plus the cost of materials and 'a little extra' for profit. If he thinks of himself as worth ₹25/hour and raw materials cost ₹10, then ₹40 would probably be close to his asking price.

An entrepreneur would realize that his device can save someone five hours of work. So the value he perceives for his device is attached to its utility. How long it took him to create it would be irrelevant. An entrepreneur might see the same device as worth ₹200 if the person using it is able to avoid ₹250 or ₹300 of expenses he would otherwise incur.

For an employee, time is money. For an entrepreneur, leverage is money. Employees 'work hard,' and their efforts and rewards are linear. Entrepreneurs 'work smart' and their efforts and rewards are exponential. For instance, an employee makes a widget in an hour, two widgets in two hours, ten in ten hours. An entrepreneur would be more inclined to sell widgets or teach people about widgets, because these activities are scalable. That is, he can teach just one person about a widget in an hour, or in that same hour he could teach a thousand people the same thing. It takes no more effort to teach a thousand people than it does to teach just one. However, with more students comes greater benefit. The entrepreneur understands these economies of scale and takes advantage of them. Employees don't, and may even think that this sort of leverage is, somehow, dishonest or immoral. He might reason that since the effort of the teacher didn't change with the size of the class, the benefit to the teacher shouldn't grow with the number of students.

Employees tend to think win-lose. There's a saying, "Employees work just hard enough to not get fired, and employers pay them just enough to keep them from quitting." An attitude of 'just getting by' is common for someone in the employee mindset, but is unthinkable for the successful entrepreneur. Unfortunately, many budding entrepreneurs are deceived by unrealistic promises and projections, and they may expect their new venture to run on auto-pilot after they get a web site up and run a few ads. Doing as little as possible, and doing as much as possible, are polar opposites. Successful entrepreneurs are always in the latter group.

Employees tend to think of getting, where entrepreneurs tend to think of giving. What are the main concerns that a prospective employee brings to the interview? "How much will you pay me, what are the medical benefits, how much time for vacation?" Entrepreneurs are more focussed on, "What are your needs? How can I help you? How can I help you save money?" Again, these are polar opposite ways of thinking. Entrepreneurs hire employees, not the other way around. And employees get by while entrepreneurs get rich. Which would you rather be?

Finally, employees tend to think short-term, and entrepreneurs think long-term. An employee wants to get paid this week, and an entrepreneur realizes it may be months, or maybe even years, before his business is paying well enough to support him. It's the difference between pumping water and planting seeds. If you start pumping, you will get water quickly, but the flow stops when you stop working. If you plant seeds, you will eventually get fruit. And you will continue to get fruit long after you've planted your last seed.

There are other challenges, to be sure: uncertainty, financial struggles during start-up, long hours, non-supportive spouse or friends, changing markets, etc. But the biggest single reason that entrepreneurs struggle is because they haven't learned to think like entrepreneurs. It's not technique, or the 'opportunity' or the market. It's attitude.

Fortunately, there is no great mystery in overcoming this one major challenge. It's a matter of desire and discipline. Simply find successful entrepreneurs and ask them what books they recommend. Then, turn off your TV and start reading. Saturate your mind with the wisdom of those who have already succeeded. Read about what they have done and how they did it, then model your own efforts after theirs. At the same time, shield yourself as much as possible from the 'employee' mindset. Be aware that your thinking habits are deeply entrenched, and it will take consistent effort over time to change.

The Bible speaks directly to this when it says, "For as he thinketh in his heart, so is he", and "Keep thy heart with all diligence; for out of it are the issues of life." Many are the testimonies of people who thought success was "out there" – some goal to be reached or thing to be obtained, and then discovered afterward what God has been telling us all along.

In short, if you think like a successful entrepreneur, and work like a successful entrepreneur, you will be a successful entrepreneur. The only person standing in your way is you.

Challenges before Entrepreneur

- No rules protecting employers
- Global competition
- Changes around the globe
- Lack of balance between projects and personnel
- Delayed payments
- Uncertain return to the investor

In lieu of above challenges the entrepreneur must possess the following characteristics :

(i) *Innovation*: Entrepreneur innovate, i.e., introduce something new to maximize the interests of business. According to Peter F. Drucker, innovation is a means by which entrepreneurs exploit change as an opportunity for a different business or a different service.

Paul H.Wilken in his work, *'Entrepreneurship— a comparative and historical study' lists the following innovations by changes brought out by entrepreneurs :*

- Initial Expansion- Original production of goods.
- Subsequent Expansion- Subsequent changes in the amount of goods produced.
- Factor Innovation- Increase in supply or productivity of factors.
  - *Financial:* Procurement of capital from new source or in new form.
  - *Labour:* Procurement of labour from new source or of new type; upgrading of existing labour.
  - *Material:* Procurement of old material from new source or use of a new material.
- Production Innovation- Changes in the production process.
  - *Technological:* Use of new production technique.
  - *Organizational:* Change of form or structure of relationships among people.
- Market Innovations- Changes in the size or composition of the market.
  - *Product :* Production of new good or change in quality or cost of existing good.
  - *Market:* Discovery of a new market.

(ii) *Risk Oriented*: Assumption of all possible risks exposed by business environment is an important feature of entrepreneurship. An entrepreneurship has to undertake and bear all possible risks that may arise out of implementation of his plans or project. Some of the examples of risks are change in consumer preferences, taste and habits, possible changes in technology, government policies, availability of raw materials and other uncertain elements.

(iii) *Achievement Orientation*: McClelland emphasizes that achievement orientation is the prime factor that explains economic behavior of entrepreneurs. Achievement orientation means the quest for success in relation to preset standards of excellence. He measures interest of entrepreneurs in terms of profit or achievement motive which remains constant regardless of change in events.

(iv) *Involves Managerial Skills and Leadership*: Mere building entrepreneurship process is not enough, entrepreneurs need to manage the business efficiently and effectively as well. Leadership and managerial skills are interwoven in entrepreneurship right from infant stage of an enterprise. Initial business decisions determine the success and failure of an enterprise. An entrepreneur devoid of these qualities is bound to fail.

(v) *Impact of Cultural and Religious Factors*: Cultural and religious factors determine the mental attitude towards work and desire to acquire money or wealth. Societies wherein people are more influenced by religion seldom feel attracted to materialistic goals. Such societies are prone to have lower degree of adventurism and entrepreneurship.

(vi) *Entrepreneurship is a Practice*: According to Peter Drucker, "*Entrepreneurship is neither a science nor an art. It is a practice. It has a knowledge base. Knowledge in entrepreneurship is a means to an end. Indeed, what constitute knowledge in practice is largely defined by the ends, that is, by the practice*."

Thus, entrepreneurship is applying the entrepreneurial traits. It apart from individual abilities is determined by the constituents of environment to which an enterprise is exposed.

(vii) *An Economic Activity*: Entrepreneurship involves establishing and running an enterprise. Enterprises are established to produce and distribute goods and services. Therefore, entrepreneurship is an economic activity.

FINANCING ENTREPRENEURIAL BUSINESS

Finance is the base of all business activities. The entrepreneurship also depends upon the financing activities. Obtaining adequate access to capital is one of the biggest hurdle of business. The entrepreneur must take all financial activities on one to one basis. Entrepreneur in its day to day function have to plan for resource assessment, then check the fixed and working capital requirements, funds flow, sources and means of finance.

Resource Assessment

It is the most important activity of the entrepreneur to allocate the resource of the finance. The resource may be self financed or it may be from some other ways like loan etc. But, the main focus is to have finance. The factors affecting business may be financial or non financial. Financial factors include the source and cost of finance. The non financial factors have also bearing over the resource assessment.

Fixed and Working Capital Requirement

Fixed and working capital requirement depends upon many factors like industry, place of business, credit limits etc. Some business requires more fixed capital and some more working capital. The business like manufacturing or production requires more fixed capital and trading activities need more working capital.

Funds Flow

It is one of the activity of the entrepreneur to analyse the funds and cash with it. These tests shows that the enterprises day to day functioning and also the income, expenditure and the status of the flow of the funds.

Sources of Finance

An enterprise may use any of the source to finance its activities. There are two types of sources of finance. One is internal and other is external. It depends upon the need of the business to take the help of any source of the finance for enterprise. The external type of source of finance may be from relatives, friends or banks etc.

Means of Finance

Means by which a budget deficit is financed or a surplus is used. Means of financing are not included in the budget totals. The primary means of financing is borrowing from the public. In general, the cumulative amount borrowed from the public (debt held by the public) will increase if there is a deficit and decrease if there is a surplus, although other factors can affect the amount that the government must borrow. Those factors, known as *other means of financing*, include reductions (or increases) in the government's cash balances, changes in outstanding checks, changes in accrued interest costs included in the budget but not yet paid, and cash flows reflected in credit financing accounts.

GROWTH AND CHALLENGES OF ENTREPRENEURSHIP

Risk taking ability, Self-confidence, Decision making ability, Knowledge of cumin growing to harvesting technology, Economic motivation, Market orientation, Risk factors, Soil and firm condition of experiences, Water resources, Water quality and volumes, need to cumin for all technical factors, Ability of co-ordination to cumin related activities, Achievement, Motivation, etc. indicators are behaviour of entrepreneurial.

Entrepreneurship has gained greater significance at global level under changing economic scenario. Global economy in general and Indian economy in particular is poised for accelerated growth driven by entrepreneurship. Admits environment of super mall culture we find plenty of scope for entrepreneurship in trading and manufacturing.

An entrepreneur is a person who is able to look at the environment, identify opportunities to improve the environmental resources and implement action to maximize those opportunities (Robert E. Nelson) it is important to bear in mind the entrepreneurial skills that will be needed to improve the quality of life for individuals, families and communities and to sustain a healthy economy and environment. Taking this into consideration, we will find that each of the traditional definitions has its own weakness.

The first definition leaves little room for innovations that are not on the technological or organizational cutting edge, such as, adaptation of older technologies to a developing-country context, or entering into export markets already tapped by other firms. Defining entrepreneurship as risk-taking neglects other major elements of what we usually think of as entrepreneurship, such as a well-developed ability to recognize unexploited market opportunities.

Entrepreneurship as a stabilizing force limits entrepreneurship to reading markets disequilibriam, while entrepreneurship defined as owning and operating a business, denies the possibility of entrepreneurial behaviour by non-owners, employees and managers who have no equity stake in the business. Therefore, the most appropriate definition of entrepreneurship that would fit into the rural development context, argued here, is the broader one, the one which defines entrepreneurship as: “a force that mobilizes other resources to meet unmet market demand”, “the ability to create and build something from practically nothing”, “the process of creating value by pulling together a unique package of resources to exploit an opportunity”.

It combines definitions of entrepreneurship by Jones and Sakong, 1980; Timmons, 1989; Stevenson, et al., 1985. Entrepreneurship so defined, pertains to any new organization of productive factors and not exclusively to innovations that are on the technological or organizational cutting edge, it pertains to entrepreneurial activities both within and outside the organization. Entrepreneurship need not involve anything new from a global or even national perspective, but rather the adoption of new forms of business organizations, new technologies and new enterprises producing goods not previously available at a location.

This is why entrepreneurship is considered to be a prime mover in development and why nations, regions and communities that actively promote entrepreneurship development, demonstrate much higher growth rates and consequently higher levels of development than nations, regions and communities whose institutions, politics and culture hinder entrepreneurship. An entrepreneurial economy, whether on the national, regional or community level, differs significantly from a non-entrepreneurial economy in many respects, not only by its economic structure and its economic vigorousness, but also by the social vitality and quality of life which it offers with a consequent attractiveness to people.

Economic structure is very dynamic and extremely competitive due to the rapid creation of new firms and the exit of ‘old’ stagnant and declining firms redefining entrepreneurship and innovation Succeeding as an entrepreneur and an innovator in today’s world is vastly different from what it was earlier. Organizations will face seven trends in the next decade as they flight to survive, grow and remain competitive.

- Speed and uncertainty will prevail.
- Technology will continue to disrupt and enable.
- Demographics will dictate much of what happens in business.
- Loyalty will erode.
- Work will be done anywhere, anytime.
- Employment as we know it will disappear.

The entrepreneurs provide a magical touch to an organization, whether in public or private or joint sector, in achieving speed, flexibility, innovativeness, and a strong sense of self-determination. They bring a new vision to the forefront of economic growth.

Effecting Change

The fostering entrepreneurship and business growth is clearly important for economic development. When a planned economy transforms to free-market system, the importance of entrepreneurship is emphasised, since such a tradition did not previously exist in the business culture. In most cases, the transdormation includes privatisation of publicly owned property and therefore, changes in ownership structure in the economy. Several challenges exist in changing ownership structures in an optimal fashion. Appropriate physical and institutional infrastructure will be needed to attract private investment, and well designed strategies and policies should be introduced to provide a welcoming environment for businesses. As transformation is much more than an economic process. It is change.

Modernisation

The development in business needs modernising. This is the reason why we must take into account several tips for improving the material base of our organisation.

The first step is to take is research - try to find the pros and cons of production - what gives the most of benefits and what might be afforded to remain the same. This makes to take reasonable steps to renew the most crucial sectors of production process.

The next step is the resources required for modernization - modernizing is expensive and even though it is a good investment. This is the reason why to rely on what we have earned from our company so far. The better option is to find a proper creditor - this might be a bank or another financial organisation be beware of the conditions of the loan about to take - do not take risks that cannot be afforded and not to miss any good opportunity.

The last step but also that important is the efficient modernizing approach. The company cannot afford wasting time in modernization or use outdated methods – there is a need to get the newest improvements for production process and install them as quickly as possible. This would not only save time - this would give opportunity to renew the production and start earning immediately - this is the cost of a good modernization. For example, if the industry is Hotels in Shimla and considering moving to internet booking then you need to consider: how will this fit in with the current system; will it increase the number of people staying at our hotel; and will it decrease costs in the long term?

By following these essential steps in modernization, the company would not only expand, but will have an improved and modern material base that would both motivate employees additionally and will strengthen the production process and product quality.

Expansion

The expansion of venture is its period of unfolding and maturation. In everyday speech, there is little difference in meaning between “growth and “expansion.” In business parlance, the terms sometimes differ, with “growth” having the connotation of an internal or vertical surge, whereas “expansion” refers to external or horizontal growth, such as that exhibited by a firm that successfully engages in mergers and acquisitions. In reality, however, very few ventures reach the latter stage of operation; most entrepreneurs are quite content to aim for some degree of vertical growth, to settle for a comfortable position in the market place.

Diversification

The term ‘diversification is usually used to mean the introduction of a new product or service to meet the need of an old market. How improvement should take place for the old product have to be considered before? Pleitner’s interpretation is useful: diversification is an expansion of the range of product. This broad definition can embrace offerings of an existing product (or service) in a new market; a new product into an established market; and a new product in a new market.

All these moves have a common thing that is an attempt to increase sale by expanding selling possibilities. And the expansion of sales is a key goal in the firm's growth phase.

LESSON ROUND UP

- The main objective of business planning is to provide and implement the formal and systematic business plan. The objective of formal business plan is to be in the circle of contemporary business standard formality and the requirements in the region where business is operating.
- Strategic plan formulate the effective management concentrates on opportunities and threats in long-range plans. It defined the venture's specific, measurable, achievable, reachable, time frame, exciting, and rewarding to the respective future business direction.
- Operational planning translates that strategy into the everyday execution tactics of the business that will ultimately produce the outcomes defined by the strategy.
- Both the Central Government and various State Governments are taking increased interest in promoting the growth of entrepreneurship.
- Individuals are being encouraged to form new businesses and are being provided such government support as tax incentives, buildings, roads, and a communication system to facilitate this creation process.
- The two types of entrepreneurship may be classified as:
    - Opportunity-based entrepreneurship- an entrepreneur perceives a business opportunity and chooses to pursue this as an active career choice.
    - Necessity-based entrepreneurship- an entrepreneur is left with no other viable option to earn a living. It is not the choice but compulsion, which makes him/her, choose entrepreneurship as a career.
- It is believed that India has an extraordinary talent pool with virtually limitless potential to become entrepreneurs. India must focus on four areas:
    - Create the Right Environment for Success
    - Ensure that Entrepreneurs have access to the Right Skill
    - Ensure that Entrepreneurs have access to 'Smart Capital'
    - Enable Networking and Exchange.
- Finance is the base of all business activities. The entrepreneurship also depends upon the financing activities. Entrepreneur in its day to day function have to plan for resource assessment, then check the fixed and working capital requirements, funds flow, sources and means of finance.
    - Resource Assessment
    - Fixed and Working Capital Requirement
    - Funds Flow
    - Sources of Finance
    - Means of Finance.

– Risk taking ability, Self-confidence, Decision making ability, Knowledge of cumin growing to harvesting technology, Economic motivation, Market orientation, Risk factors, Soil and firm condition of experiences, Water resources, Water quality and volumes, need to cumin for all technical factors, Ability of co-ordination to cumin related activities, Achievement, Motivation, etc. indicators are behaviour of entrepreneurial.

GLOSSARY

Business Plan A business plan is a document that summarizes the operational and financial objectives of a business and contains the detailed plans and budgets showing how the objectives are to be realized.

SELF-TEST QUESTIONS

1. What are the important elements for an entrepreneurial venture?
2. Explore the nature of strategic planning.
3. What are the key dimensions that influence a firm's planning process.

Suggested Readings

(i) Entrepreneurship, Growth and Development – by Rashi Ali, Chugh Publication.

FOUNDATION PROGRAMME

BUSINESS ENVIRONMENT AND ENTREPRENEURSHIP

PRACTICE TEST PAPER

(This Test Paper is for practice and self study only and not to be sent to the Institiute)

1. Business Environment is effected by ———————— factors
   (a) Internal
   (b) External
   (c) Both a and b
   (d) None of above
2. Environment factor which are beyond the control of individual is known as ———
   (a) Internal
   (b) External
   (c) Both a and b
   (d) None of above
3. Change in technology, political factors, demand of population are ——— factors
   (a) Internal
   (b) External
   (c) both a and b
   (d) None of above
4. ——— factors affects the organization and not necessary to the whole economy
   (a) Micro factor
   (b) Macro factors
   (c) Both A and B
   (d) None of above
5. It is the ————— which tells the purpose of existence of business
   (a) Mission
   (b) Vision
   (c) Both A and B
   (d) None of above
6. To develop caliber professionals facilitating good corporate governance is————————— of ICSI
   (a) Mission

Students are advised to read instruction on Computer based examinations available on ICSI websit www.icsi.edu

(b) Vision

(c) Both A and B

(d) None of above

7. Which of the following would have unlimited liability-

   (a) Cooperative society

   (b) Company

   (c) Shareholders

   (d) Sole proprietorship

8. Which of the following are the advantages of Sole proprietorship –

   (a) Better control

   (b) Quick decision

   (c) Easy to form and Shut

   (d) All of above

9. The affairs of the business is managed by head of the family known as Karta in-

   (a) Hindu undivided Family

   (b) Partnership firm

   (c) Company

   (d) Cooperative society

10. What is the maximum strength of HUF-

    (a) 20

    (b) 10

    (c) 50

    (d) No limit

11. Mutual agency is the important feature of-

    (a) Hindu undivided Family

    (b) Partnership firm

    (c) Company

    (d) Cooperative society

12. Company is having perpetual succession and work under common seal. This statement is-

    (a) True

    (b) False

    (c) Partly true

    (d) Partly false

13. Scale of business determines the –
    (a) Size of the business
    (b) Capital involved in business
    (c) Production of such business
    (d) All of above
14. For the goods having artistic features—————— size of enterprise is preferred.
    (a) Small scale
    (b) Large scale
    (c) Corporation
    (d) Very large
15. Economical advantages can be taken from-
    (a) Small scale production
    (b) Large scale production
    (c) Both A and B
    (d) Cooperative society
16. Economies derived from large scale of business are-
    (a) Internal
    (b) External
    (c) Both a and b
    (d) None of above
17. Advantages of Multi national companies are-
    (a) Funds availability
    (b) Provision of employments
    (c) Increasing competitions
    (d) All of above
18. Financial suitability and job opportunity is the advantages in————scale of operation.
    (a) Small scale
    (b) Large scale
    (c) Corporation
    (d) Very small
19. BPO stands for –
    (a) Business process outsourcing
    (b) Business public organization
    (c) Business private organization

(d) Business people organization

20. Providing permission to use technical know how by parent organization to another individual is known as-

 (a) Franchising

 (b) Agency

 (c) Marketing

 (d) Dealership

21. Sales forecast is difficult in-

 (a) Network marketing

 (b) E commerce

 (c) M commerce

 (d) Marketing

22. KPO stands for-

 (a) Knowledge process outsourcing

 (b) Knowledge public organization

 (c) Key public offer

 (d) Know potential output

23. PDA, smart phone, computer mediated network are the need in ————————-

 (a) Network marketing

 (b) E-commerce

 (c) M commerce

 (d) Marketing

24. B2B, B2C, C2B are the types of –

 (a) Network marketing

 (b) E-commerce

 (c) M commerce

 (d) Marketing

25. ————————— is the primary function of management

 (a) Planning

 (b) Budgeting

 (c) Controlling

 (d) Organization

26. Choice of production, need of customer, gaining over competitor is ————— level strategy.

 (a) Corporate level

 (b) Business unit

(c) Operational level

(d) All of above

27. SCM stands for –

(a) Supply chain management

(b) Supply chain material

(c) Supply choice material.

(d) Source concept management

28. Film production is the example of-

(a) Low technology job

(b) High technology job

(c) Complex job

(d) Both B and C

29. Financial management comprises of –

(a) Financial decision

(b) Investment decision

(c) Dividend decision

(d) All of above

30. Selling + customer satisfaction =

(a) Network marketing

(b) E-commerce

(c) M commerce

(d) Marketing

31. Principle of equitable and good is ———— part of law

(a) Natural

(b) Positive

(c) Sociological

(d) Realistic

32. Hindu and Mohammedan law is ——-

(a) Personal law

(b) Principle law

(c) Customary law

(d) Historical law

33. Company work under a ——-

(a) Seal

(b) Common seal

(c) Stamp

(d) None of above

34. Company has ———— Succession

(a) Longer

(b) Continue

(c) Perpetual

(d) Limited

35. ——— have homogeneous Member

(a) Hindu undivided family

(b) Partnership firm

(c) Company

(d) Cooperatives

36. If company do not follow the principle of separate legal entity ————— can be done-

(a) Lifting of corporate veil

(b) Principle of equity

(c) Principle of natural justice

(d) All of above

37. Maximum number of members in private company is————-

(a) 200

(b) 30

(c) 20

(d) 10

38. Total managerial remuneration in a public company can not be ——— of net profit.

(a) 10%

(b) 11%

(c) 8%

(d) 5%

39. Audit of government company is done by C&AG this statement is –

(a) True

(b) False

(c) Partly true

(d) Partly false

40. Association not for profit has to take ———— from central government.
    (a) License
    (b) Approval
    (c) Grant
    (d) Certificate
41. ———————— is the first step for formation of company.
    (a) Promotion
    (b) Publicity
    (c) Incorporation
    (d) Business commencement
42. —————— company enjoys the number of privileges.
    (a) Public company
    (b) Private company
    (c) Multi national company
    (d) Banking company
43. Any corporate body/ Association of firm can be appointed as director of the company. This statement is-
    (a) True
    (b) False
    (c) Partly true
    (d) Partly false
44. Any increase in the number of director beyond the maximum limit provided in articles can be done by-
    (a) Share Holders
    (b) Managing Director
    (c) Manager
    (d) Registrar of company
45. Gap between two Annual general meeting can not be exceeding to——— month
    (a) 12 month
    (b) 6 month
    (c) 15 month
    (d) None of above
46. Disqualification for being director of company is defined under section ——— of the Companies Act, 2013
    (a) 164
    (b) 275
    (c) 252
    (d) 226

47. First directors are usually name in ———————— of company.
    (a) Articles of company
    (b) Memorandum of company
    (c) Both A and B
    (d) None of above
48. ——————— director is appointed in the place of original director in case of his absence.
    (a) Alternate director
    (b) Additional director
    (c) Substitute director
    (d) All of above
49. Maximum Number of members in case of a public company is ———————
    (a) Unlimited
    (b) 200
    (c) 1000
    (d) 5000
50. Casual vacancy is filled up by ———————-
    (a) Board of Director
    (b) Shareholders
    (c) Central government
    (d) Company law board
51. Removal of director can be done by –
    (a) Shareholders
    (b) Central government
    (c) Company law board
    (d) All of above
52. Minimum number of member(s) for one person company is/are ___________________
    (a) 1
    (b) 2
    (c) 3
    (d) No limit
53. ——————— is the essential feature for formation of partnership.
    (a) Agreement
    (b) Memorandum
    (c) Relation
    (d) All of above

54. True test of partnership is –
    (a) Mutual agency
    (b) Mutual relation
    (c) Mutual Communication
    (d) Sharing of profit
55. Minor can be a partner in a new formed firm. This statement is –
    (a) True
    (b) False
    (c) Partly true
    (d) Partly false
56. There are ————— type of partnership –
    (a) 1
    (b) 2
    (c) 3
    (d) No such type
57. One can be the member of HUF by————
    (a) Agreement
    (b) Birth
    (c) Permission
    (d) All of above
58. Goodwill is the ———————— of firm
    (a) Property
    (b) Asset
    (c) Liability
    (d) All of above
59. The Indian Contract act extends to –
    (a) Whole of india
    (b) Whole of india except jammu and Kashmir
    (c) Jammu and Kashmir
    (d) None of above
60. General principle of Indian contract act is defined under section –
    (a) 1 to 75
    (b) 1 to 70
    (c) 124 to 236
    (d) 124 to 238

61. Agreement + enforceability=
    (a) Contract
    (b) Offer
    (c) Invitation to offer
    (d) Legal relation
62. Catalogue of price in shop or store is the example of-
    (a) Contract
    (b) Offer
    (c) Invitation to offer
    (d) Advertisement
63. Leading case which defined the basic principle of General offer –
    (a) Carllil vs Carbolic Smoke Ball and Company
    (b) Lalman Shukla vs Gauri Dutt
    (c) Cox vs Hickman
    (d) Belfour vs Belfour
64. Consideration need to be adequate, this statement is –
    (a) True
    (b) False
    (c) Partly true
    (d) Partly false
65. Agreement which is not enforceable by law is-
    (a) Void agreement
    (b) Voidable agreement
    (c) Voidable contract
    (d) Illegal agreement
66. Damage can be remote, this statement is –
    (a) True
    (b) False
    (c) Partly true
    (d) Partly false
67. Injunction order is issued by –
    (a) Court
    (b) Company
    (c) Company law board
    (d) None of above

68. Contract with undue influence and coercion is –
    (a) Voidable contract
    (b) Void contract
    (c) Illegal contract
    (d) Void agreement

69. Goods are defined under section-
    (a) 2(7)
    (b) 2(5)
    (c) 2(4)
    (d) 2(1)

70. Agreement to sale is in relation to———————— goods
    (a) Existing goods
    (b) Future Goods
    (c) Specific goods
    (d) None of the above

71. The word entrepreneurship is derived from the French word –
    (a) Entreprendre
    (b) Entreprendur
    (c) Entrepreneurde
    (d) Entropre

72. "Entrepreneur is someone who actually searches for change responds to it and exploits those changes as an opportunity" this statement is given by –
    (a) Peter Drucker
    (b) H.N. Hansen
    (c) Koontz o'donnel
    (d) Joseph Schumpeter

73. Which one of the following does not include in personal attribute of an entrepreneur –
    (a) Dedication
    (b) Passion
    (c) Flexibility
    (d) Biasness

74. To start ones new business, entrepreneur needs to leave——————and enter into ——————————
    (a) Safe, unsafe
    (b) Comfort zone, twilight zone

(c) Twilight zone, comfort zone

(d) Unsafe zone, safe

75. Principle of innovation was given by-

(a) Steve jobs

(b) H.N. Hansen

(c) Koontz o'donnel

(d) Joseph Schumpeter

76. PESTLE is part of which type of environment-

(a) Micro

(b) Macro

(c) External

(d) Business

77. T in SWOT stands for –

(a) Threats

(b) Tasks

(c) Tactics

(d) Technology

78. Industry analysis is given by which of the following-

(a) Porter

(b) H.N. Hansen

(c) Koontz o'donnel

(d) Joseph Schumpeter

79. Which of the following is an economic factor –

(a) Exchange rates

(b) Licensing regulations

(c) Labour courts

(d) Employment needs

80. Sell———— and not————— is the statement given by steve jobs.

(a) Company, customers

(b) Desire, wants

(c) Product, dreams

(d) Dreams, product

81. Which of the following, entrepreneurship does not offer –

(a) Independence and freedom

(b) Recognition

(c) Opportunity of being own boss

(d) Less income

82. Bill gates is considered which of the type of entrepreneur –

(a) Visionary

(b) Superstar

(c) sustainer

(d) idealist

83. Charm and high energy relates to which of the following –

(a) Visionary

(b) Superstar

(c) sustainer

(d) idealist

84. Intrapreneur faces competition from –

(a) Entrepreneurs

(b) Managers

(c) Employees within the organisation

(d) All the above

85. Which of the following is not the characteristics of entrepreneurship

(a) Innovation

(b) Organising skills

(c) Indifference approach

(d) Risk taking

86. Entrepreneurship work for _______

(a) Profits

(b) Salary

(c) Remuneration

(d) Commission

87. which of the following is not technique is not used in business environment scanning?

(a) PESTEL analysis

(b) Industry analysis

(c) Swot Analysis

(d) Government analysis

88. Ongoing scanning at an almost unconscious level is_____

(a) Directed scanning

(b) Active scanning

(c) Passive scanning

(d) Indirect Scanning

89. Which of the following does not include in marketing assessment process –

(a) Defining the problem

(b) Fstering ideas

(c) Feedback

(d) Designing a plan

90. Business plans are only for start up companies, it is a –

(a) Myth

(b) Reality

(c) Both A and B

(d) None of the above

91. Who claimed that entrepreneurship requires no ordinary skill –

(a) Mill

(b) Smith

(c) Ricardo

(d) None of the above

92. Alfred marshall gave the necessity of entrepreneurship in-

(a) 1880

(b) 1867

(c) 1890

(d) 2002

93. Employees relate to which of the following –

(a) Work smart

(b) Work hard

(c) Do not wok

(d) Work all day all night

94. Overcoming the obstacles of right attitude in entrepreneurship is not matter of which of the following-

(a) Desire

(b) Discipline

(c) Both A and B

(d) Fraudulent

95. Peter drucker suggested entrepreneurship is –
    (a) Science
    (b) Art
    (c) Profession
    (d) Practice
96. Entrepreneurship should always ready to accept the –
    (a) Modernization
    (b) Expansion
    (c) Diversification
    (d) All of the above
97. Introduction of new products and services and adding it to product line is known as –
    (a) Modernization
    (b) Expansion
    (c) Diversification
    (d) All of the above
98. Entrepreneur should have access to –
    (a) Right skill
    (b) Right environment
    (c) Smart capital
    (d) All of the above
99. Which of the following is not the stage of entrepreneur firm-
    (a) Seed
    (b) Start
    (c) Growth
    (d) Final stage
100. Which of the following is needed to grow the entrepreneurship –
    (a) Media
    (b) Society
    (c) Government
    (d) All of above

ANSWERS

1. (c)
2. (b)
3. (b)
4. (a)
5. (a)
6. (a)
7. (d)
8. (d)
9. (a)
10. (d)
11. (b)
12. (a)
13. (d)
14. (a)
15. (b)
16. (c)
17. (d)
18. (b)
19. (a)
20. (a)
21. (a)
22. (a)
23. (c)
24. (b)
25. (a)
26. (b)
27. (a)
28. (d)
29. (d)
30. (d)
31. (a)
32. (a)
33. (b)
34. (c)
35. (a)
36. (a)
37. (a)
38. (b)
39. (a)
40. (a)
41. (a)
42. (b)
43. (b)
44. (a)
45. (c)
46. (a)
47. (a)
48. (a)
49. (a)
50. (a)
51. (d)
52. (a)
53. (a)
54. (a)
55. (b)
56. (b)
57. (b)
58. (a)
59. (b)
60. (a)
61. (a)
62. (c)
63. (a)
64. (b)
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66. (b)
67. (a)
68. (a)
69. (a)
70. (b)
71. (a)
72. (a)
73. (d)
74. (b)
75. (a)
76. (b)
77. (a)
78. (a)
79. (b)
80. (d)
81. (d)
82. (a)
83. (b)
84. (c)
85. (c)
86. (a)
87. (d)
88. (d)
89. (c)
90. (a)
91. (a)
92. (c)
93. (b)
94. (d)
95. (d)
96. (d)
97. (c)
98. (d)
99. (d)
100. (d)