

## CONCEPT OF BUSINESS

Literally, the word “business” means the state of being busy. Generally, the term business includes all human activities concerned with earning money. In other words, business is an activity in which various persons regularly produce or exchange goods and services for mutual gain or profit.

The goods and services produced or purchased for personal use are not included in “business”.

### DEFINITION

**1. According to L. H. Haney**

“Business may be defined as human activities directed toward providing or acquiring wealth through buying and selling of goods.”

**2. James Stephenson says that:**

“Every human activity which is engaged in for the sake of earning profit may be called business.”

**3. In the words of B. W. Wheeler**

“An institution organized and operated to provide goods and services to the society, under the incentive of private gain” is business.

## SCOPE OF BUSINESS ORGANIZATION

### SOLE PROPRIETORSHIP

Sole proprietorship is a simple and oldest form of business organization. Its formation does not require any complicated legal provision like registration etc. It is a small-scale work, as it is owned and controlled by one person, and operated for his profit. It is also known as “sole ownership”, “individual partnership” and “single proprietorship”.

### DEFINITION

Following are some important definition of sole proprietorship:

**1. According to D.W.T. Stafford**

“It is the simplest form of business organization, which is owned and controlled by one man.”

**2. According to G. Baker**

“Sole proprietorship is a business operated by one person to earn profit.”

# CHARACTERISTICS

Following are the main characteristics of sole proprietorship:

## 1. Capital

In sole proprietorship, the capital is normally provided by the owner himself. However, if additional capital is required, such capital can be increased by borrowing.

## 2. Easy Dissolution

The sole proprietorship can be easily dissolved, as there are no legal formalities involved in it.

## 3. Easily Transferable

Such type of business can easily be transferred to another person without any restriction.

## 4. Freedom of Action

In sole proprietorship, single owner is the sole master of the business; therefore, he has full freedom to take action or decision.

## 5. Formation

Formation of sole proprietorship business is easy as compared to other business, because it does not require any kind of legal formality like registration etc.

## 6. Legal Entity

In sole proprietorship, the business has no separate legal entity apart from the sole traders.

## 7. Legal Restriction

There are no legal restrictions for sole traders to set up the business. But there may be legal restrictions for setting up a particular type of business.

## 8. Limited Life

The continuity of sole proprietorship is based on good health, or life or death of the sole owner.

## 9. Management

In sole proprietorship, the control of management of the business lies with the sole owner.

## 10. Ownership

The ownership of business in sole proprietorship is owned by one person.

**11. Profit**

The single owner bears full risk of business; therefore, he gets total benefit of the business as well as total loss.

**12. Size**

The size of business is usually small. The limited ability and capital do not allow the expansion of business.

**13. Success of Business**

The success and goodwill of the sole proprietorship is totally dependent upon the ability of the sole owner.

**14. Secrecy**

A sole proprietorship can easily maintain the secrecy of his business.

**15. Unlimited Liability**

A sole proprietor has unlimited liability. In case of insolvency of business, even the personal assets are used by the owner to pay off the debts and other liabilities.

**ADVANTAGES OF SOLE PROPRIETORSHIP**

Following are the advantages of sole proprietorship:

**1. Contacted with the Customers**

In sole proprietorship a businessman has direct contact with the customer and keeps in mind the like and dislikes of the public while producing his products.

**2. Direct Relationship with Workers**

In sole proprietorship a businessman has direct relationship with workers. He can better understand their problems and then tries to solve them.

**3. Easy Formation**

Its formation is very easy because there are not legal restrictions required like registration etc.

**4. Easy Dissolution**

Its dissolution is very simple because there are no legal restrictions required for its dissolution and it can be dissolved at any time.

**5. Easy Transfer of Ownership**

A sole proprietorship can easily be transferred to other persons because of no legal restriction involved.

**6. Entire Profit**

Sole proprietorship is the only form of business organization where the owner enjoys 100% profit.

**7. Entire Control**

In sole proprietorship the entire control of the business is in the hands of one person. He can do whatever he likes.

**8. Flexibility**

There is great flexibility in sole proprietorship. Business policies can easily be changed according to the market conditions and demand of people.

**9. Honesty**

The sole master of the business performs his functions honestly and effectively to make the business successful.

**10. Independence**

It is an independent form of business organization and there is no interference of any other person.

**11. Personal Satisfaction**

As all the Business activities are accomplished under the supervision of sole owner, so he feels personal satisfaction that the business is running smoothly.

**12. Prime Credit Standing**

A sole proprietor can borrow money more easily because of unlimited liability.

**13. Quick Decisions**

Sole proprietor can make quick decisions for the development and welfare of his business and in this way can save his time.

**14. Personal Interest**

A sole proprietor takes keen interest in the affairs of business because he alone is responsible for profit and loss.

**15. Saving in Interest on Borrowed Capital**

Sometimes, a sole proprietor borrows money to increase his capital, from his relatives, without interest.

**16. Saving in Legal Expenses**

As there are no legal restrictions for the formation of sole proprietorship so it helps in increasing savings as legal expenses are reduced.

### **17. Saving in Management Expenses**

The owner of the business himself performs most of the functions so it reduces the management expenses.

### **18. Saving in Taxes**

The tax rates are very low on sole proprietorship because it is imposed on the income of single person.

### **19. Secrecy**

It is an important factor for the development of business. A sole trader can easily maintain the secrecy about the techniques of production and profit.

### **20. Social Benefits**

It is helpful in solving many social problems like unemployment etc.

## **DISADVANTAGES OF SOLE PROPRIETORSHIP**

The disadvantages of sole proprietorship can be narrated as under:

### **1. Continuity**

The continuity of sole proprietorship depends upon the health and life of the owner. In case of death of the owner the business no longer continues.

### **2. Chances of Fraud**

In sole proprietorship, proper records are not maintained. This increases the chances of errors and frauds for dishonest workers.

### **3. Expansion Difficulty**

In sole proprietorship, it is very difficult to expand the business because of the limited life of proprietor and limited capital.

### **4. Lack of Advertisement**

As the sources of single person are limited so he cannot bear the expense of advertisement, which is also a major disadvantage.

### **5. Lack of Capital**

Generally, one-man resources are limited, so due to financial problems he cannot expand his business.

### **6. Lack of Inspection and Audit**

In sole proprietorship there is lack of inspection and audit, which increases the chances of fraud and illegal operations.

**7. Lack of Innovation**

Due to fear of suffering from loss, a sole proprietor does not use new methods of production. So, there is no invention or innovation.

**8. Lack of Public Confidence**

The public shows less confidence in this type of business organization because there is no legal registration to control and wind up the business.

**9. Lack of Skilled Persons**

One person cannot hire the services of qualified and skilled persons because he has limited resources. It is also a great disadvantage.

**10. Management Difficulty**

One person cannot perform all types of duties effectively. If he is a good accountant, he may not be a good administrator. Due to this, business suffers a loss.

**11. Much Strain on Health**

In this type of business organization there is much strain on the health of the businessman because he alone handles all sorts of activities.

**12. Not Durable**

This type of business organization is not durable because its existence depends upon the life of sole proprietor.

**13. Permanent Existence**

In this type of business there is a need of permanent existence of a businessman. In case of absence from business for few days may become the cause of loss.

**14. Risk of Careless Drawings**

In sole proprietorship, owner himself is a boss. There is no question to his decisions or actions. So, there is a risk of careless drawings by him.

**15. Risk of Loss**

In case of sole proprietorship, a single person bears all the losses, whereas in the case of partnership or Joint Stock Company all the partners or members bear the loss.

**16. Unlimited Liability**

In sole proprietorship there is unlimited liability. It means, in case of loss personal property of the owner can be sold to satisfy the claimants. It is a great disadvantage.

## **CONCLUSION**

From the above-mentioned detail, we come to the point that despite the above disadvantages, sole proprietorship is an important form of business organization. This is due to the fact that its

formation is very easy and due to unlimited liability, the owner takes great care and interest in the business, because in case of loss, he is personally responsible. As he enjoys entire profit, this factor also encourages him to work with great efficiency which promotes his business.

## **PARTNERSHIP**

**Partnership and its Characteristics** Partnership is the second stage in the evolution of forms of business organization. It means the association of two or more persons to carry on as co-owners, i.e. a business for profit. The persons who constitute this organization are individually termed as partners and collectively known as firm; and the name under which their business is conducted is called “The Firm Name”.

In ordinary business the number of partners should not exceed 20, but in case of banking business it must not exceed 10. This type of business organization is very popular in Pakistan.

## **DEFINITION**

### **1. According to Section 4 of Partnership Act, 1932**

“Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.”

### **2. According to Mr. Kent**

“A contract of two or more competent persons to place their money, efforts, labour and skills, some or all of them, in a lawful commerce or business and to divide the profits and bear the losses in certain proportion.”

## **CHARACTERISTICS**

The main characteristics of partnership may be narrated as under:

### **1. Agreement**

Agreement is necessary for partnership. Partnership agreement may be written or oral. It is better that the agreement is in written form to settle the disputes.

### **2. Audit**

If partnership is not registered, it has no legal entity. So there is no restriction for the audit of accounts.

### **3. Agent**

In partnership every partner acts as an agent of another partner.

### **4. Business**

Partnership is a business unit and a business is always for profit. It must not include club or charitable trusts, set up for welfare.

**5. Cooperation**

In partnership mutual cooperation and mutual confidence is an important factor. Partnership cannot take place with cooperation.

**6. Dissolution**

Partnership is a temporary form of business. It is dissolved if a partner leaves, dies or declared bankrupt.

**7. Legal Entity**

If partnership is not registered, it has no legal entity. Moreover, partnership has no separate legal entity from its members and vice versa.

**8. Management**

In partnership all the partners can take part or participate in the activities of business management. Sometimes, only a few persons are allowed to manage the business affairs.

**9. Number of Partners**

In partnership there should be at least two partners. But in ordinary business the partners must not exceed 20 and in case of banking business it should not exceed 10.

**10. Object**

Only that business is considered as partnership, which is established to earn profit.

**11. Partnership Act**

In Pakistan, all partnership businesses are running under Partnership Act, 1932.

**12. Payment of Tax**

In partnership, every partner pays the tax on his share of profit, personally or individually.

**13. Profit and Loss Distribution**

The distribution of profit and loss among the partners is done according to their agreement.

**14. Registration**

Many problems are created in case of unregistered firm. So, to avoid these problems partnership firm must be registered.

**15. Relationship**

Partnership business can be carried on by all partners or any of them can do the business for all.



### **16. Share in Capital**

According to the agreement, every partner contributes his share of capital. Some partners provide only skills and ability to become a partner of business and earn profit.

### **17. Transfer of Rights**

In partnership no partner can transfer his shares or rights to another person, without the consent of all partners.

### **18. Unlimited Liability**

In partnership the liability of each partner is unlimited. In case of loss, the private property of the partners is also used up to pay the business debts.

## **ADVANTAGES OF PARTNERSHIP**

Following are the advantages of partnership:

### **1. Simplicity in Formation**

This type of business organization can be formed easily without any complex legal formalities. Two or more persons can start the business at any time. Its registration is also very easy.

### **2. Simplicity in Dissolution**

Partnership Business can be dissolved at any time because of no legal restrictions. Its dissolution is easy as compared to Joint Stock Company.

### **3. Sufficient Capital**

Partnership can collect more capital in the business by the joint efforts of the partners as compared to sole proprietorship.

### **4. Skilled Workers**

As there is sufficient capital so a firm is in a better position to hire the services of qualified and skilled workers.

### **5. Sense of Responsibility**

As there is unlimited liability in case of partnership, so every partner performs his duty honestly.

### **6. Satisfaction of Partners**

In this type of business organization each partner is satisfied with the business because he can take part in the management of the business.

**7. Secrecy**

In partnership it is not compulsory to publish the accounts. So, the business secrecy remains within partners. This factor is very helpful for successful operation of the business.

**8. Social Benefit**

Two or more partners with their resources can build a strong business. This factor is very helpful in solving social problems like unemployment.

**9. Expansion of Business**

In this type of business organization, it is very easy to expand business volume by admitting new partners and can borrow money easily.

**10. Flexibility**

It is flexible business and partners can change their business policies with the mutual consultation at any time.

**11. Tax Facility**

Every partner pays tax individually. So, a firm is in a better position as compared to Joint Stock Company.

**12. Public Factor**

Public shows more confidence in partnership as compared to sole proprietorship. If a firm is registered, people feel no risk in creating relations with such business.

**13. Prime Credit Standing**

The liabilities of partners are unlimited, so the banks and other financial institutions provide them credit easily.

**14. Minority Protection**

In partnership all policy matters are decided with consent of each partner. This gives protection to minority partners.

**15. Moral Promotion**

Partnership is the best business for small investors. It promotes moral courage of partners.

**16. Distribution of Work**

There is distribution of work among the partners according to their ability and experience. This increases the efficiency of a firm.

**17. Combined Abilities**

Every partner possesses different ability, which helps in running the business effectively, when combined.

### **18. Absence of Fraud**

In partnership each partner can look after the business activities. He can check the accounts. So, there is no risk of fraud.

## **DISADVANTAGES OF PARTNERSHIP**

The disadvantages of partnership are enumerated one by one as under:

### **1. Unlimited Liability**

It is the main disadvantage of partnership. It means in case of loss, personal property of the partners can be sold to pay off the firm's debts.

### **2. Limited Life of Firm**

The life of this type of business organization is very limited. It may come to an end if any partner dies or new partner enters into business.

### **3. Limited Capital**

No doubt, in partnership, capital, is greater as compared to sole proprietorship, but it is small as compared to Joint Stock Company. So, a business cannot be expanded on a large scale.

### **4. Limited Abilities**

As financial resources of partnership are limited as compared to Joint Stock Company, so it is not possible to engage the services of higher technical and qualified persons. This causes the failure of business, sooner or later.

### **5. Limited number of Partners**

In partnership, the number of partners is limited, so the resources are also limited. That's why business cannot expand on large scale.

### **6. Legal Defects**

There are no effective rules and regulations to control the partnership activities. So, it cannot handle large-scale production.

### **7. Lack of Interest**

Partners do not take interest in the business activities due to limited share in profit and limited chances of growth of business.

### **8. Lack of Public Confidence**

As there is no need by law to publish accounts in partnership, so people lose confidence and avoid dealing and entering into contract with such firm.

### **9. Lack of Prompt Decision**

In partnership all decisions are made by mutual consultation. Sometimes, delay in decisions becomes the cause of loss.

### **10. Lack of Secrecy**

In case of misunderstandings and disputes among the partners, business secrets can be revealed.

### **11. Chances of Dispute among Partners**

In partnership there are much chances of dispute among the partners because all the partners are not of equal mind.

### **12. Expansion Problem**

Partnership business may not be expanded due to limited number of partners, limited capital and unlimited liability.

### **13. Frozen Investment**

It is easy to invest money in partnership but very difficult to withdraw it. 14. Risk of Loss  
There is a risk of loss due to less qualified and less experienced people.

### **14. Transfer of Rights**

In partnership no partner can transfer his share without the consent of all other partners.

## **CONCLUSION**

From the above-mentioned findings, we come to this point that despite the above disadvantages, partnership is an important form of business organization. This is because its formation is very easy and due to unlimited liabilities, partners take great interest in business, because in case of loss they are personally responsible.

## **PARTNERS**

“The individuals who comprise a partnership are known as partners.”

## **KINDS OF PARTNERS**

Partners can be classified into different kinds, depending upon their extent of liability, participation in management, share of profits and other facts.

### **1. Active Partner**

A partner who takes active part in the affairs of business and its management is called active partner. He contributes his share in the capital and is liable to pay the obligations of the firm.

**2. Secret Partner**

A partner who takes active part in the affairs of the business but is unknown to the public as a partner is called secret partner. He is liable to the creditors of the firm.

**3. Sleeping Partner**

A partner who only contributes is the capital but does not take part in the management of the business is known as sleeping partner. He is liable to pay the obligations of the firm.

**4. Silent Partner**

A partner who does not take part in the management of business but is known to the public as partner is called silent partner. He is liable to the creditors of the firm.

**5. Senior Partner**

A partner who invests a large portion of capital in the business is called senior partner. He has a prominent position in the firm due to his experience, skill, energy, age and other facts.

**6. Sub-Partner**

A partner in a firm can make an agreement with a stranger to share the profits earned by him from the partnership business. A sub-partner is not liable for any debt and can not interfere in the business matters.

**7. Junior Partner**

A person who has a small investment in the firm and has a limited experience of business is called junior partner.

**8. Major Partner**

A major partner is a person who is over 18 years of age. A person is allowed to make contract when he has attained the age of majority.

**9. Minor Partner**

A person who is minor cannot enter into a valid contract. However, he can become a partner with the consent of all other partners. A minor can share profits of a business but not the losses.

**10. Nominal Partner**

A partner who neither contributes in capital nor does he take part in the management of the business but allows his name to be used in the business is known as nominal partner. He is individually and jointly liable for the debts of the firm along with other partners.

**11. Deceased Partner**

A partner whose life has expired is known as deceased partner. The share of capital and profit of such partner is paid to his legal heirs in lump sum or in installment.

### **12. Limited Partner**

A partner whose liabilities are limited to his share in business is called limited partner. He cannot take active part in the management of the firm.

### **13. Unlimited Partner**

A partner whose liabilities are unlimited is known as unlimited partner. He and his personal property both are liable to clear the debts of the firm.

### **14. Incoming Partner**

A person who is newly admitted in the firm with the consent of all the partners is called incoming partner. He is not liable for any act of the firm performed before he became the partner unless he agrees.

### **15. Retired Partner**

A partner who leaves the firm due to certain reasons is known as retired partner or outgoing partner. He is liable to pay all the obligations and debts of the firm incurred before his retirement.

### **16. Partner in Profits only**

If a partner is entitled to receive certain share of profits and is not held liable for losses is known as partner in profits only. He is not allowed to take part in the management of the business.

### **17. Quasi Partner**

A person, who was the partner of a firm but has now retired from active participation in business and has left his capital in the business as a loan, receiving interest on it, is known as quasi partner.

### **18. Partner by Estoppel**

A person who holds himself out as a partner of a firm, before a third party or allows other to do so, though he is not a partner of that firm, is called partner by estoppel or holding out partner. He is not entitled to any right like other partners of the firm. He is not entitled to any right like other partners of the firm. He is personally liable to the third party for the credit given to the firm, on the faith of his representation.

## **KINDS OF PARTNERSHIP**

There are three kinds of partnership which are described as under:

1. Partnership at will
2. Particular partnership
3. Limited partnership

## **PARTNERSHIP AT WILL**

If the partnership is formed for an undefined time, it is called partnership at will. Any partner can dissolve it at any time by giving the notice.

- **According to Partnership Act, 1932:**

“If no provision is made in the agreement regarding the partnership, it is called partnership at will.”

Partnership at will may be created under the following circumstances:

- 1. Indefinite Period**

If partnership has been formed for an indefinite period, it is called partnership at will.

- 2. Existence after Completion of Venture**

If partnership has been formed for a particular venture and after completion such venture it remains continue, it becomes a partnership at will.

- 3. Existence after Expiry of Period**

If partnership has been formed for a definite time period, so after the expiry of this period, it becomes partnership at will.

## **PARTICULAR PARTNERSHIP**

If the partnership is formed for a particular object of temporary nature, it is called particular partnership. On completion of a particular venture, it comes to an end. Under this no regular business is done. For example: Partnership for the construction of a building and partnership for producing a film.

## **LIMITED PARTNERSHIP**

Limited partnership is that in which liabilities of some partners are limited up to the amount of their capitals. In this partnership, there is at least one partner who has unlimited liability.

In Pakistan, this type of partnership is not formed. There is a separate partnership act for it.

## **MAIN FEATUTRES**

Main features of partnership are:

- 1. Limited Partner**

There is at least one partner who has limited liability.

- 2. Unlimited Partner**

There is at least one partner who has unlimited liability.

### **3. Number of Partners**

There are at least two partners or maximum 20 in an ordinary business and not more than 10 in banking business.

### **4. Admission of New Partner**

New partners may be admitted in this partnership without the consent of limited partners but with the consent of unlimited partners.

### **5. Registration**

The registration of this partnership is compulsory by law.

### **6. Transferability of Shares**

Limited partner can transfer his shares to any other person with the consent of all other partners.

### **7. Inspection of Books**

Limited partner has a right to inspect the books of accounts.

### **8. Rights of Suggestions**

Limited partner has a right to give suggestions to others who manage the business.

### **9. Participation in Management**

A limited partner cannot take part in the management of the business.

### **10. Withdrawal of Capital**

A limited partner cannot withdraw his capital until he remains in partnership business.

### **11. Separate Legislation**

It is enrolled under the Limited Partnership Act, 1907, instead of Partnership Act, 1932.

## **TERMINATION OF PARTNERSHIP**

All forms of partnership under Islamic law may be terminated as:

### **1. Notice**

In all the above forms of partnership each partner has a right to terminate the partnership by giving notice to other partners.

### **2. Death**

Partnership is also terminated on the death of a partner.

## **PARTNERSHIP DEED**

Partnership deed is a document that contains the terms and conditions of the business.



## **CONTENTS OF PARTNERSHIP DEED**

- Date on which the agreement was made.
- Name of the business
- Nature of the business
  - ✓ This clause will cover the scope of the business.
- Names, addresses, telephone Numbers and emails of the partners.
- Capital of the business
- If duration is attached with any business that should clearly be mentioned in the partnership deed.
- Duties of the partners
- Whether any partner is entitled to salary. If yes, how much amount should be given to him as salary
- Profit distribution ratio
- Whether partners are entitled to withdraw money from the business. If yes, procedure of withdrawals should also be written in the partnership deed.
- Arbitration
  - ✓ In case of a conflict, how that conflict would be resolved before going to the court.

The partner should read the partnership deed carefully, add as much clauses as possible and never take anything for granted.

## **RIGHTS OF THE PARTNERS**

- Every partner has the right to:
  - ✓ Participate in all the affairs of the business.
  - ✓ Get his/her share of profit from the business.
  - ✓ Leave the partnership according to the terms and conditions of the partnership deed.
  - ✓ Claim the salary against his/her services.
  - ✓ Participate in the management of the business.

## **DUTIES OF THE PARTNERS**

- Partners have to maintain accounts which describe the true picture of the business.
- Partners should use their powers within limits specified in the partnership deed.
- Partners are responsible to provide accurate information to Government bodies.
- Partners are responsible to pay their share in case of loss to the business.
- It is duty of every partner to obey the decision that has been made in the partnership.
- Partners should not disclose any secret information about the business to any other person.

# JOINT STOCK COMPANY

Joint Stock Company is the third major form of business organization. It has entirely different organizational structure from sole proprietorship and partnership. There are two advantages of Joint Stock Company. First of all, it enjoys the advantage of increased capital. Secondly, the company offers the protection of limited liability to the investors. The law relating to Joint Stock Company has been laid in Companies Ordinance, 1984, which came into force on January 1, 1985 in Pakistan.

## DEFINITIONS

Following are some important definition of Joint Stock Company:

- 1. Simple Definition**

“A company may be defined as an association of persons for the purpose of making profit.”

- 2. According to Kimball,**

“A corporation by nature is an artificial person, created or authorized by a legal statute for some specific purpose.”

- 3. According to S.E. Thomas,**

“A company is an incorporated association of persons formed usually for the pursuit of some commercial purpose.”

## FEATURES OF JOINT STOCK COMPANY

Following are the main features of a Joint Stock Company.

- 1. Creation of Law**

A joint stock company is the creation of law or special ‘Act’ of the state. It is formed and governed by the Companies Ordinance or by a special Act of the legislature. Pakistani companies are incorporated under the Companies Ordinance, 1984.

- 2. Capital Borrowing**

The company can borrow capital in its own name to expand the business.

- 3. Separate Legal Entity**

A Joint Stock Company has separate legal entity, apart from its members. It can sue in a court of law in its own name.

- 4. Legal Person**

A Joint Stock Company, as a legal person, has the usual rights of any person to carry on the business in its own name, to own property, to borrow or lend money and to enter into contract.

**5. Long Life**

A joint stock company has long life as compared to other forms of business organizations.

**6. Limited Liability**

The liability of the shareholder is limited to the extent of the face value of the shares they hold.

**7. Large Scale Business**

Because of more members, a company has larger capital as compared to sole trade ship and partnership, which helps in doing business on large scale.

**8. Management of Company**

The shareholders elect the Board of Directors in the Annual General Meeting and all the management is selected by the Board of Directors.

**9. Number of members**

In case of private limited company, minimum number of shareholders is '2' and maximum is '50'; but in case of public limited company, minimum number is '7' and there is no limit for maximum number.

**10. Transferability of Shares**

A shareholder of a company can easily transfer his shares to other persons. There is no restriction on the purchase and sale of shares.

**11. Trade Agreement**

A joint stock company enjoys separate existence, so it can join the trade agreements with other firms in its own name.

**12. Purchases and Sale of Property**

A joint stock company can purchase and sale the property in its own name.

**13. Payment of Taxes**

A joint stock company pays double taxes to the government.

**14. Object**

The basic object of a joint stock company is to earn profit. Whole profit is not distributed among the shareholders. Some portion is transferred to General Reserve for emergencies.

**15. Government Control**

A joint stock company has to comply with the rules of the government. It has to audit its accounts.

## **16. Easy Mode of Investment**

The capital of a joint stock company is divided into the shares of small value. So, every person can purchase these shares according to his income and saving.

## **17. Common Seal**

Since a company is an artificial person created by law, therefore, it cannot sign documents for itself. The common seal, with the name of the company is used as a substitute for its signature.

# **ADVANTAGES OF JOINT STOCK COMPANY**

Following are the advantages of Joint Stock Company:

### **1. Expansion of Business**

A joint stock company sells the shares, debentures and bonds on large scale. So, a joint stock company can collect a large amount of capital and can expand its business.

### **2. Easy Access to Credit**

A joint stock company can get a huge amount of capital from banks and other institutions.

### **3. Easy to Exit**

It is easy to separate oneself from a joint stock company by selling his shares.

### **4. Experts' Services**

Because a joint stock company has a strong financial position, so it may hire the service of qualified and technical experts.

### **5. Employment**

Joint stock companies are also playing very important role to provide employment to unemployed persons of the country.

### **6. Flexibility**

There is flexibility in such business organizations.

### **7. Limited Liability**

The liability of the owner is limited. In case of loss, the shareholders are not required to pay anything more than the face value of the shares.

### **8. Large Scale Production**

Availability of huge amounts of capital makes possible for a joint stock company to produce goods on very large scale, at a lower cost.

### **9. Larger Capital**

There is no problem of capital in a joint stock company because there is not limit for maximum number of members. So, a joint stock company collects capital from many people.

### **10. Long Life**

A joint stock company has a permanent life. If one or more than one shareholder die, or sell their shares, it makes no difference to the company. New shareholders take their place.

### **11. Long-term Projects**

A joint stock company has a permanent and long life and huge capital. Such organizations can undertake the projects, which may give profit after many years.

### **12. Spread of Risk**

In joint stock company, the risk of business is spread over a large number of people. Such organizations can undertake risky projects, which other types or organization do not take.

### **13. Transfer of Shares**

In joint stock company, the shares of public limited company can be easily transferred or disposed off. There is no restriction on the transfer of shares in a joint stock company.

### **14. Increase in Saving and Investment**

The shares are in large number, but their value is small. The shares of a company may have a value of Rs.10, Rs.100 etc. So, rich as well as poor can purchase the shares of a company. This leads to increase in savings and investment.

### **15. Better Management**

Such organization is administered by the elected directors. These directors are generally experienced and qualified in business field. This increases the efficiency of the company.

### **16. Beneficial Advices**

A joint stock company can take beneficial advices from the government at the time of need which reduces the chances of its failure.

### **17. Public Confidence**

A joint stock company is created by law and is supervised by legal authority. So, a joint stock company can easily win the public confidence.

### **18. Higher Profits**

With the help of larger capital and technical skill, the cost of production is reduced, which increases the rate of profit.

## DISADVANTAGES OF JOINT STOCK COMPANY

Some of the disadvantages of the joint stock company are given below:

### 1. Initial Difficulties

It is more difficult to establish a joint stock company as compared to other business organizations.

### 2. Lack of Interest

Most shareholders become relaxed and leave all the functions to be carried out by the directors. This usually encourages the directors to promote their own interest at the cost of the company.

### 3. Labor Disputes

In such organization there is no close contact of the workers with the owners or the shareholders. This leads to formation of labor unions to fight against the company's management.

### 4. Lack of Responsibility

There is lack of personal interest and responsibility in the business of a joint stock company. If any mistake occurs, everybody tries to shift or transfer his responsibilities to other persons and he remains safe.

### 5. Lack of Secrecy

A joint stock company cannot maintain its secrecy due to the reason that a company has to submit various reports to the registrar.

### 6. Lack of Freedom

A joint stock company cannot perform its functions freely because it has to submit various reports to the registrar from time to time.

### 7. Monopoly

Due to larger size and resources, a joint stock company is in a position to create monopoly. Sometimes a few customers make agreement and exploit the consumers.

### 8. Speculation

Due to free transfer of shares and limited liability, speculation in the stock market takes place, which may affect the economy of the country.

### 9. Corruption

The directors of the company do not show the picture of the company to the public and encourage corruption by changing the policies for their personal interest.

### **10. Complicated Process**

The formation of a joint stock company is a complicated process due to many legal formalities.

### **11. Centralization of Power**

In joint stock Company, all the powers have in a few hands and due to this; an ordinary shareholder cannot participate in the affairs of a company.

### **12. Double Taxes**

A joint stock company has to pay double taxes to the government. Firstly, company pays tax on the whole profit of the company. Secondly, every shareholder pays tax on his individual income.

### **13. Exploitation**

Ordinary shareholders do not have full information about the affairs of their company. So, they are exploited.

### **14. Problem of Large-Scale Production**

Since joint stock company produces on large-scale, so many problems arise in the economy.

### **15. Nepotism**

In a joint stock company, the directors of company employ their inefficient and incapable relatives and friends and give key jobs to them. As a result, the company suffers a loss.

### **16. Late Decision**

In joint stock company, the decision-making process is time consuming because a meeting is necessary to solve the business problems and matters.

## **DIFFERENCE BETWEEN PUBLIC LIMITED COMPANY AND PRIVATE LIMITED COMPANY**

### **1. Number of members**

- For a public limited company, minimum number of members is seven
- For a private limited company, minimum number of members is two

### **2. Issue of shares**

- Public limited company is bound to promote issue of shares to general public through media.
- There is no such provision for private limited company.

### **3. Name of the company**

- Public limited companies add the word “Ltd.” with their name.
- Private limited companies add the word “(Pvt) Ltd.” with their name.

### **4. Annual report**

- Public limited companies have to present their data to general public.
- There is no such provision for private limited company.

### **5. Transfer of shares**

- It is easy to transfer shares in public limited companies.
- In private limited company, shareholder cannot transfer the shares without the consent of other members.

### **6. Statutory meeting**

- It is obligatory for the public limited company to hold statutory meeting.
- There is no such obligation for private limited company.

### **7. Submission of annual report**

- It is obligatory for the public limited companies to submit their annual report to registrar Corporate Law Authority.
- It is not necessary for private limited company.

### **8. Taxation**

- Public limited company pays double taxation at different income tax rates.
- Private limited company pays tax only once at different income tax rates.

## **BUSINESS CYCLES**

1. During 1920s, UK saw rapid growth in Gross Domestic Product (GDP), production levels and living standards. The growth was fuelled by new technologies and production processes such as the assembly line. The economic growth also caused an unprecedented rise in stock market values.
2. China's recent economic slowdown and financial mayhem are fostering a cycle of decline and panic across much of the world, as countries of nearly every continent see escalating risks of prolonged slumps, political disruption and financial losses.

What are these? These are examples of business cycles. The first example shows that the UK economy was going through boom during 1920s while the second example of the recent slowdown in China indicates the beginning of a recessionary phase.

The economic history of nearly all countries point towards the fact that they have gone through fluctuations in economic activities i.e. there have been periods of prosperity alternating with



periods of economic downturns. These rhythmic fluctuations in aggregate economic activity that an economy experiences over a period of time are called business cycles or trade cycles. A trade cycle is composed of periods of good trade characterised by rising prices and low unemployment percentage, altering with periods of bad trade characterised by falling prices and high unemployment percentages. In other words, business cycle refers to alternate expansion and contraction of overall business activity as manifested in fluctuations in measures of aggregate economic activity, such as, gross national product, employment and income.

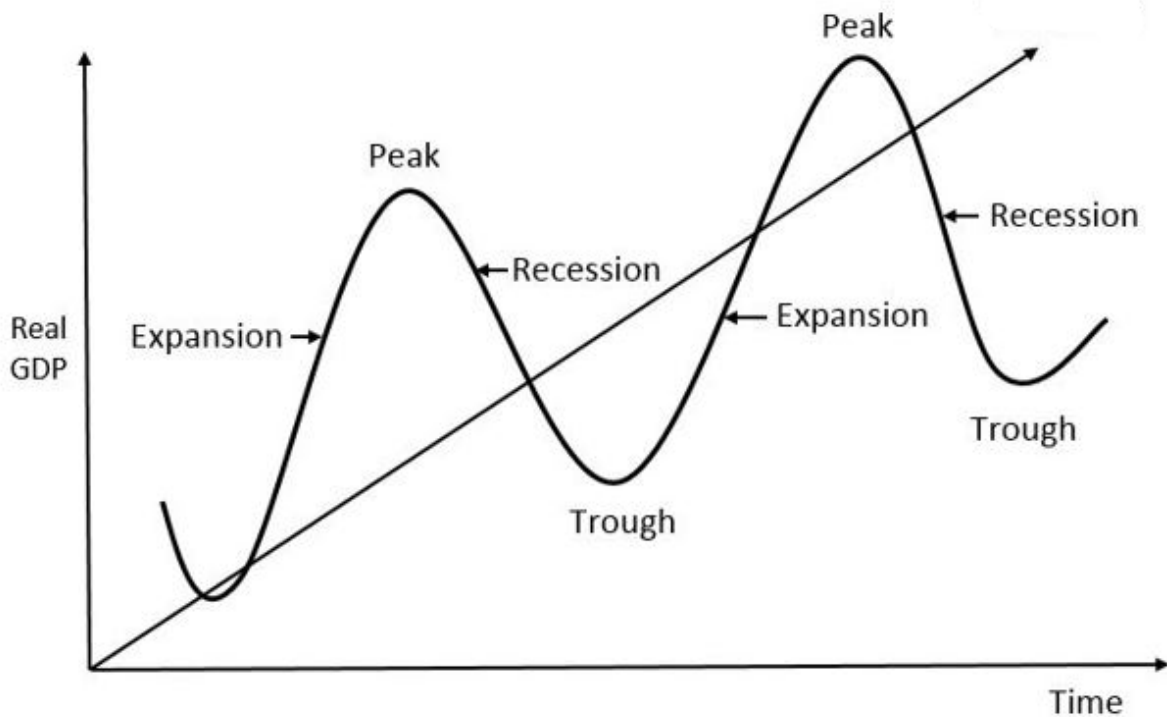
A noteworthy characteristic of these economic fluctuations is that they are recurrent and occur periodically. That is, they occur again and again but not always at regular intervals, nor are they of the same length. It has been observed that some business cycles have been long, lasting for several years while others have been short ending in two to three years.

## **PHASES OF BUSINESS CYCLE**

We have seen above that business cycles or the periodic booms and slumps in economic activities reflect the upward and downward movements in economic variables. A typical business cycle has four distinct phases. These are:

- 1. Expansion (also called Boom or Upswing)**
- 2. Peak or boom or Prosperity**
- 3. Contraction (also called Downswing or Recession)**
- 4. Trough or Depression**

The four phases of business cycle are shown in Figure 1. The broken line (marked ‘trend’) represents the steady growth line or the growth of the economy when there are no business cycles. The figure starts with ‘trough’ when the overall economic activities i.e. production and employment, are at the lowest level. As production and employment expand, the economy revives, and it moves into the expansion path. However, since expansion cannot go on indefinitely, after reaching the ‘peak’, the economy starts contracting. The contraction or downturn continues till it reaches the lowest turning point i.e. ‘trough’. However, after remaining at this point for some time, the economy revives again, and a new cycle starts.



- **Expansion:** The expansion phase is characterised by increase in national output, employment, aggregate demand, capital and consumer expenditure, sales, profits, rising stock prices and bank credit. This state continues till there is full employment of resources and production is at its maximum possible level using the available productive resources. Involuntary unemployment is almost zero and whatever unemployment is there is either frictional (i.e. due to change of jobs, or suspended work due to strikes or due to imperfect mobility of labour) or structural (i.e. unemployment caused due to structural changes in the economy). Prices and costs also tend to rise faster. Good amounts of net investment occur, and demand for all types of goods and services rises. There is altogether increasing prosperity and people enjoy high standard of living due to high levels of consumer spending, business confidence, production, factor incomes, profits and investment. The growth rate eventually slows down and reaches its peak.
- **Peak:** The term peak refers to the top or the highest point of the business cycle. In the later stages of expansion, inputs are difficult to find as they are short of their demand and therefore input prices increase. Output prices also rise rapidly leading to increased cost of living and greater strain on fixed income earners. Consumers begin to review their consumption expenditure on housing, durable goods etc. Actual demand stagnates. This is the end of expansion and it occurs when economic growth has reached a point where it will stabilize for a short time and then move in the reverse direction.

- **Contraction:** The economy cannot continue to grow endlessly. As mentioned above, once peak is reached, increase in demand is halted and starts decreasing in certain sectors. During contraction, there is fall in the levels of investment and employment. Producers do not instantaneously recognise the pulse of the economy and continue anticipating higher levels of demand, and therefore, maintain their existing levels of investment and production. The consequence is a discrepancy or mismatch between demand and supply. Supply far exceeds demand. Initially, this happens only in few sectors and at a slow pace, but rapidly spreads to all sectors. Producers being aware of the fact that they have indulged in excessive investment and over production, respond by holding back future investment plans, cancellation and stoppage of orders for equipments and all types of inputs including labour. This in turn generates a chain of reactions in the input markets and producers of capital goods and raw materials in turn respond by cancelling and curtailing their orders. This is the turning point and the beginning of recession.

Decrease in input demand pulls input prices down; incomes of wage and interest earners gradually decline resulting in decreased demand for goods and services. Producers lower their prices in order to dispose off their inventories and for meeting their financial obligations. Consumers, in their turn, expect further decreases in prices and postpone their purchases. With reduced consumer spending, aggregate demand falls, generally causing fall in prices. The discrepancy between demand and supply gets widened further. This process gathers speed and recession becomes severe. Investments start declining; production and employment decline resulting in further decline in incomes, demand and consumption of both capital goods and consumer goods. Business firms become pessimistic about the future state of the economy and there is a fall in profit expectations which induces them to reduce investments. Bank credit shrinks as borrowings for investment declines, investor confidence is at its lowest, stock prices fall and unemployment increases despite fall in wage rates. The process of recession is complete and the severe contraction in the economic activities pushes the economy into the phase of depression.

- **Trough and Depression:** Depression is the severe form of recession and is characterized by extremely sluggish economic activities. During this phase of the business cycle, growth rate becomes negative and the level of national income and expenditure declines rapidly. Demand for products and services decreases, prices are at their lowest and decline rapidly forcing firms to shutdown several production facilities. Since companies are unable to sustain their work force, there is mounting unemployment which leaves the consumers with very little disposable income. A typical feature of depression is the fall in the interest rate. With lower rate of interest, people's demand for holding liquid money (i.e. in cash) increases. Despite lower interest rates, the demand for credit declines because investors' confidence has fallen. Often, it also happens that the availability of

credit also falls due to possible banking or financial crisis. Industries, especially capital and consumer durable goods industry, suffer from excess capacity. Large number of bankruptcies and liquidation significantly reduce the magnitude of trade and commerce. At the depth of depression, all economic activities touch the bottom and the phase of trough is reached. It is a very agonizing period causing lots of distress for all. The great depression of 1929-33 is still cited for the enormous misery and human sufferings it caused.

- **Recovery:** The economy cannot continue to contract endlessly. It reaches the lowest level of economic activity called trough and then starts recovering. Trough generally lasts for some time and marks the end of pessimism and the beginning of optimism. This reverses the process. The process of reversal is initially felt in the labour market. Pervasive unemployment forces the workers to accept wages lower than the prevailing rates. The producers anticipate lower costs and better business environment. A time comes when business confidence takes off and gets better, consequently they start to invest again and to build stocks; the banking system starts expanding credit; technological advancements require fresh investments into new types of machines and capital goods; employment increases, aggregate demand picks up and prices gradually rise. Besides, price mechanism acts as a self-correcting process in a free enterprise economy. The spurring of investment causes recovery of the economy. This acts as a turning point from depression to expansion. As investment rises, production increases, employment improves, income improves, and consumers begin to increase their expenditure. Increased spending causes increased aggregate demand and in order to fulfil the demand more goods and services are produced. Employment of labour increases, unemployment falls and expansion takes place in the economic activity. It is to be reemphasized that no economy follows a perfectly timed cycle and that the business cycles are anything but regular. They vary in intensity and length. There is no set pattern which they follow. Some cycles may have longer periods of boom, others may have longer period of depression.

## Examples of Business Cycles

### Great Depression of 1930

The world economy suffered the longest, deepest, and the most widespread depression of the 20th century during 1930s. It started in the US and became worldwide. The global GDP fell by around 15% between 1929 and 1932. Production, employment and income fell. As far as the causes of Great Depression are concerned, there is difference of opinion amongst economists. While British economist John Maynard Keynes regarded lower aggregate expenditures in the economy to be the cause of massive decline in income and employment, monetarists opined that the Great Depression was caused by the banking

crisis and low money supply. Many other economists blamed deflation, over indebtedness, lower profits and pessimism to be the main causes of Great Depression. Whatever may be the cause of the depression, it caused wide spread distress in the world as production, employment, income and expenditure fell. The economies of the world began recovering in 1933. Increased money supply, huge international inflow of gold, increased governments' spending due to World War II etc., were some of the factors which helped economies slowly come out of recession and enter the phase of expansion and upturn.

### **Information Technology bubble burst of 2000**

Information Technology (IT) bubble or Dot.Com bubble roughly covered the period 1997-2000. During this period, many new Internet-based companies (commonly referred as dot-com companies) were started. The low interest rates in 1998-99 encouraged the start-up internet companies to borrow from the markets. Due to rapid growth of internet and seeing vast scope in this area, venture capitalists invested huge amount in these companies. Due to over optimism in the market, investors were less cautious. There was a great rise in their stock prices and in general, it was noticed, that companies could cause their stock prices to increase by simply adding an "e-" prefix to their name or a ".com" to the end. These companies offered their services or end products for free with the expectation that they could build enough brand awareness to charge profitable rates for their services later. As a result, these companies saw high growth and a type of bubble developed. The "growth over profits" mentality led some companies to engage in lavish internal spending, such as elaborate business facilities. These companies could not sustain long. The collapse of the bubble took place during 1999-2001. Many dot-com companies ran out of capital and were acquired or liquidated. Nearly half of the dot-com companies were either shut down or were taken over by other companies. Stock markets crashed and slowly the economies began feeling the downturn in their economic activities.

### **Global Economic Crisis (2008-09)**

The recent global economic crisis owes its origin to US financial markets. Following Information Technology bubble burst of 2000, the US economy went into recession. In order to take the economy out of recession, the US Federal Reserve (the Central Bank of US) reduced the rate of interest. This led to large liquidity or money supply with the banks. With lower interest rates, credit became cheaper and the households, even with low creditworthiness, began to buy houses in increasing numbers. Increased demand for houses led to increased prices for them. The rising prices of housing led both households and banks to believe that prices would continue to rise. Excess liquidity with banks and availability of new financial instruments led banks to lend without checking the creditworthiness of borrowers. Loans were given even to sub-prime households and also

to those persons who had no income or assets. Houses were built in excess during the boom period and due to their oversupply in the market, house prices began to decline in 2006. Housing bubble got burst in the second half of 2007. With fall in prices of houses which were held as mortgage, the sub-prime households started defaulting on a large scale in paying o their instalments. This caused huge losses to the banks. Losses in banks and other financial institutions had a chain effect and soon the whole US economy and the world economy at large felt its impact.

## **CAUSES OF BUSINESS CYCLES**

Business Cycles may occur due to external causes or internal causes or a combination of both. The 2001 recession was preceded by an absolute mania in dot-com and technology stocks, while the 2007-09 recession followed a period of unprecedented speculation in the U.S. housing market.

### **Internal Causes**

The Internal causes or endogenous factors which may lead to boom or bust are:

- **Fluctuations in Effective Demand**

According to Keynes, fluctuations in economic activities are due to fluctuations in aggregate effective demand (Effective demand refers to the willingness and ability of consumers to purchase goods at different prices). In a free market economy, where maximization of profits is the aim of businesses, a higher level of aggregate demand will induce businessmen to produce more. As a result, there will be more output, income and employment. However, if aggregate demand outstrips aggregate supply, it causes inflation. As against this, if the aggregate demand is low, there will be lesser output, income and employment. Investors sell stocks and buy safe-haven investments that traditionally do not lose value, such as bonds, gold and the U.S. dollar. As companies lay o workers, consumers lose their jobs and stop buying anything but necessities. That causes a downward spiral. The bust cycle eventually stops on its own when prices are so low that those investors that still have cash start buying again. However, this can take a long time, and even lead to a depression.

The difference between exports and imports is the net foreign demand for goods and services. This is a component of the aggregate demand in the economy, and therefore variations in exports and imports can lead to business fluctuations as well. Thus, increase in aggregate effective demand causes conditions of expansion or boom and decrease in aggregate effective demand causes conditions of recession or depression. (You will study about these concepts in detail at Intermediate level in Economics for Finance.

- **Fluctuations in Investment**

According to some economists, fluctuations in investments are the prime cause of business cycles. Investment spending is considered to be the most volatile component of the aggregate demand. Investments fluctuate quite often because of changes in the profit expectations of entrepreneurs. New inventions may cause entrepreneurs to increase investments in projects which are cost-efficient or more profit inducing. Or investment may rise when the rate of interest is low in the economy. Increases in investment shift the aggregate demand to the right, leading to an economic expansion. Decreases in investment have the opposite effect.

- **Variations in government spending**

Fluctuations in government spending with its impact on aggregate economic activity result in business fluctuations. Government spending, especially during and after wars, has destabilizing effects on the economy.

- **Macroeconomic policies**

Macroeconomic policies (monetary and -fiscal policies) also cause business cycles. Expansionary policies, such as increased government spending and/or tax cuts, are the most common method of boosting aggregate demand. This results in booms. Similarly, softening of interest rates, often motivated by political motives, leads to inflationary effects and decline in unemployment rates. Anti-inflationary measures, such as reduction in government spending, increase in taxes and interest rates cause a downward pressure on the aggregate demand and the economy slows down. At times, such slowdowns may be drastic, showing negative growth rates and may ultimately end up in recession.

- **Money Supply**

According to Hawtrey, trade cycle is a purely monetary phenomenon. Unplanned changes in supply of money may cause business fluctuation in an economy. An increase in the supply of money causes expansion in aggregate demand and in economic activities. However, excessive increase of credit and money also set off inflation in the economy. Capital is easily available, and therefore consumers and businesses alike can borrow at low rates. This stimulates more demand, creating a virtuous circle of prosperity. On the other hand, decrease in the supply of money may reverse the process and initiate recession in the economy.

- **Psychological factors**

According to Pigou, modern business activities are based on the anticipations of business community and are affected by waves of optimism or pessimism. Business fluctuations are the outcome of these psychological states of mind of businessmen. If entrepreneurs are optimistic about future market conditions, they make investments, and as a result, the expansionary phase may begin. The opposite happens when entrepreneurs are pessimistic



about future market conditions. Investors tend to restrict their investments. With reduced investments, employment, income and consumption also take a downturn and the economy faces contraction in economic activities.

According to Schumpeter's innovation theory, trade cycles occur as a result of innovations which take place in the system from time to time. The cobweb theory propounded by Nicholas Kaldor holds that business cycles result from the fact that present prices substantially influence the production at some future date. The present fluctuations in prices may become responsible for fluctuations in output and employment at some subsequent period.

## **External Causes**

The External causes or exogenous factors which may lead to boom or bust are:

- **Wars**

During war times, production of war goods, like weapons and arms etc., increases and most of the resources of the country are diverted for their production. This affects the production of other goods, capital and consumer goods. Fall in production causes fall in income, profits and employment. This creates contraction in economic activity and may trigger downturn in business cycle.

- **Post War Reconstruction**

After war, the country begins to reconstruct itself. Houses, roads, bridges etc. are built and economic activity begins to pick up. All these activities push up effective demand due to which output, employment and income go up.

- **Technology shocks**

Growing technology enables production of new and better products and services. These products generally require huge investments for new technology adoption. This leads to expansion of employment, income and profits etc. and give a boost to the economy. For example, due to the advent of mobile phones, the telecom industry underwent a boom and there was expansion of production, employment, income and profits.

- **Natural Factors**

Weather cycles cause fluctuations in agricultural output which in turn cause instability in the economies, especially those economies which are mainly agrarian. In the years when there are draughts or excessive floods, agricultural output is badly affected. With reduced agricultural output, incomes of farmers fall and therefore they reduce their demand for industrial goods. Reduced production of food products also pushes up their prices and thus reduces the income available for buying industrial goods. Reduced demand for industrial products may cause industrial recession.



- **Population growth**

If the growth rate of population is higher than the rate of economic growth, there will be lesser savings in the economy. Fewer saving will reduce investment and as a result, income and employment will also be less. With lesser employment and income, the effective demand will be less, and overall, there will be slowdown in economic activities.