Chapter 2

TYPES OF BUSINESS ORGANISATIONS

Preview

Introduction, A firm, plant, Industry, Types of Business organizations - Proprietary Firms, Partnership Firms, Joint Stock Companies, Public Sector Undertakings, Co-operative Societies, Non-profit organizations, Business Organization in new millennium, Organization Goals - Profit Maximization, sales Maximization, Satisfying Theory, other goals or objectives of firms.

INTRODUCTION

Organisation of production requires bringing together various factors of production and coordinating the efforts of all the participants in the process of production. The level at which this is done is the level of a firm.

Production with the profit motive is modern concept, in the sense that it has become dominant only after the Industrial Revolution. Before the Industrial Revolution, most of the economies of the world were agricultural economies. The profit motive was always a secondary motive in an agricultural economy. But in modern times the profit motive became the only dominant motive of production. A firm is a unit of production where production is done with the sole aim of profit maximization.

1. Definition of a firm as a producing unit.

For the sake of understanding this concept of the firm, let us study some definitions of the firm given by eminent economists.

1. Hansn : The firm may be defined as "an independently administered business unit".
2. "A firm is a centre of control where the decisions about what to produce and how to produce are taken".
3. "A firm is a business unit which hires productive resources for the purpose of producing goods and services".

4. Harvey Leibenstein : A firm is " an independent organization whose destiny is determined by the magnitude of the aggregate pay off and in which the aggregate pay off depends directly on its performance and especially on the production and sale of services or goods".

5. In the words of Prof. Lipsey, *"The firm is defined as the unit that uses factors of production to produce commodities that it then sells either to other firms, to households or to the central authorities (meaning government, public agencies etc.) The firm is thus the unit that makes the decisions regarding the employment of factors of production and the output of commodities."* How much to consume is decided by the households. In keeping with preferences of the consumers, the firms decide how much to produce, how to produce etc. Through advertisements, a firm may try to increase its sales, but the decisions to buy belong to the buyers. The decisions regarding choice of techniques and quantify of a commodity are taken by the firm. The firm is assumed to take consistent decisions in relation to the choice open to it. The internal problems regarding the process of decision - making i.e. who reaches decision, how are they reached etc. are ignored. We take firm as a single unit - smallest possible unit. It is taken as our atom of behavior on the demand side.

   Again, just as the household is assumed to seek satisfaction maximization, the firm is assumed to seek maximization of its profits.

   The firm may be a proprietorship firm or a partnership firm or a Multi-National Corporation. That it is a unit of decision - making is our criterion. Therefore, for an economist, Tata Engineering and Locomotive Company Ltd. is a firm. Again, what form of business organization and management experts? An economist assumes that the firm is internally properly organized and is capable of taking decisions.

From the above definitions, it will be seen that there is a substantial difference in all these definitions and still in their own way they describe the firm correctly. This is so because these economists have given prominence to the questions which were more important for them or for their country or when they were writing, and so if we study the various features of firm as revealed by these definitions, the concept will be more clear. **The following features of a firm emerge from these definitions:**

1) It is a centre where decisions about what, where, how and how much to produce are taken.

2) It is a centre where the means of production are hired or purchased and used for production.

3) It is a centre, where the success of production is reviewed in its entire context and decisions are taken.

4) It is a centre, where the means of production are collected, the production is done, and the sale and distribution of production is also affected.

5) It is a centre, where all the decisions about production are taken. These include decisions regarding the distribution of the product, advertising, sale and those regarding facing competition also.

From the above features of a firm, it will be clear that a firm has to perform several functions simultaneously - i.e. to produce a commodity, to sell and distribute the commodity, to advertise the commodity and to perform all those things which will be required to survive competition. To cap it all, the firm is expected to make as much profits as possible. Theoretically speaking, a firm is expected to organize all the factors of production in the most profitable manner. If one studies the structure and function of modern firm the above definitions will appear to be too simple, because in modern times the firm is expected to perform so many other functions.

Formerly, the entrepreneur was taken to be an independent factor of production. Even today the entrepreneur is no doubt a very important factor of production and has become highly indispensable that, it is very difficult to separate him from the production unit of the firm because ultimately the will to produce is provided by the entrepreneur. The mere presence of all the factors of production and a market does not guarantee production. The will to produce is very important and it cannot be separated from the entrepreneur. Thus, the entrepreneur becomes inseparable from the firm.

2. The firm and the industry

For understanding the difference between a firm and an industry, it would be advisable to understand the nature of a competitive industry. A competitive industry has three basic characteristics:

(a) Large number of firms, (b) Homogeneous product; and (c) Freedom of entry and exit.

In a competitive industry, there is a large number of firms so that the action of a single firm has no effect on the price and output of the whole industry. Every firm therefore enjoys the freedom to increase or decrease its output substantially by taking the price of the product as given. Secondly, every firm in a purely competitive industry, it must be making a product which is accepted by customers as being identical with that made by all the other producers in the industry. This is known as the condition of homogeneity. This ensures that all firms have to charge the same price. The buyers, of course, are to decide that the product is the same. The buyers should not find any real or imaginary differences between the products sold by any two pairs of firms, Finally, there should be no barriers to the entry of new firms (or exit of old firm) to (or from) the industry.

We considered competitive industry because we wanted to contrast such an industry with a monopoly. Under monopoly, there is only one firm producing a product. Entry into the industry is not free; because if entry of an additional firm is allowed, it no longer remains a monopoly. Thus, under monopoly, the firm is the industry or the *distinction between the firm and the industry disappears under conditions of monopoly.*

Between these two extremes, we get a wide range of marked structures where there are more than one firms product. Strictly speaking, all firms producing the same i.e. homogeneous product make an industry and whatever all such firms supply becomes the supply of the industry. In practice, however, we speak of the cotton textile industry, though all cotton textile units do not produce identical textile products. Though the sugar produced by sugar factories might have different grades of quality, we speak of one sugar industry. Similarly, we speak of the automobile industry, steel industry, cement industry and so on.

It should, therefore, be clear that all firms, producing a given product, together make an industry.

3. The firm and the plant

A plant is a technical unit of a given capacity of output. For example, we speak of sugar plant What is it? It is nothing but an assembly of several machines, linked together (not necessarily physically but by processes also) capable of producing a given quantity of sugar per day.

There is, for example, a weighing system which weighs the sugarcane, the conveyor system what takes the cane for crushing, the crushing machinery, and the machinery for removing impurities and so on, until finally sugar is filled in gunny bags. This whole plant taken together is capable of producing a given quantity of one product sugar. A plant thus produces any one product, obviously in cooperation with other factors of production. A sugar plant will produce sugar in co-operation with workers, managers, technicians etc. and after the necessary amounts of raw material; other chemicals and fuel are supplied to it.

The firm, on the other hand, is an economic unit. The decisions are taken by the firm. What quality of sugar is to be produced, how much of it is to be produced, to which market it should be sold and from which farmers the sugarcane should be purchased etc. are decisions to be taken by the firm.

It is not necessary that a firm has only one plant. Thus, for example, a sugar factory (i.e. a firm engaged in the production of sugar) may have a sugar plant, an alcohol plant (i.e. a distillery), a cattle - feed plant (producing cattle feed out of bagasse) - all under one management. When we say one management, we are implying one firm though there are various plants, it is also possible that a plant supplies goods to more than one firms. The difference, basically, is that between a technical unit and an economic unit.

One last word about a firm. We speak of the producer or the entrepreneur. Whenever we speak of a producer or an entrepreneur we imply a firm that takes decisions. Internally the decisions might be taken by a group of directors, managers or a sole proprietor - our unit on the supply side is the firm.

4. Types of Business Organisations

Introduction:

A business organization is concerned with how production and sale of a commodity are organized.

In this chapter, we study various forms of business organization.

- **Types of Business Organization :**

The main types of business organization are as follows:

i) One -man Business or Individual or Sole Proprietorship or Proprietary Firms.

ii) Partnership

iii) Joint Stock Company

iv) Joint Hindu Family Firms

v) Co-operative Organizations

vi) State Enterprise/Public Enterprises

vii) Joint Sector Organizations

viii) Non-Profit Organizations and

ix) Business Organizations of the New Millennium

A. Private Sector :

In a capitalist economy, the first four types of business organizations are set up in the *private sector.* The private sector is owned by private individuals, families or groups of individuals. It is characterized by private ownership in the means of production, economic freedoms and profit motive.

In addition to the first three types of business organization, there are also Joint Hindu Family Firms in the private sector in India and Business Organizations of the New Millennium.

B. Public Sector :

The public sector includes public or state enterprises like railways, posts and telegraphs, etc. The public sector is owned and controlled by the State. In India we have also a number of public enterprises like Hindustan Machine Tools, Life Insurance Corporation, Bharat Heavy Electrical Ltd. etc. They are constituted as companies, public corporations and departmental undertakings.

C. Co-operative Sector :

There are many co-operative organizations in the private sector. But they are non-capitalist in nature, e.g., Co-operative credit societies, consumers' co-operative societies, producers' co-operative societies, service societies, etc.

D. Joint Sector :

Joint sector organizations or enterprises are jointly owned by the public and private sectors. But day-today management is left to the private sector.

The following chart indicates various forms of business organization:

Types of Business Organization

- **Private Sector**
  - **Capitalist Form**
    1) Proprietary Firms or Proprietorship
    2) Partnership
    3) Joint-Stock Company
    4) Joint-Hindu Family Firms
    5) Business Organizations of the New Millennium
  - **Non - Capitalist Form**
    6) Co-operative Organizations
- **Public Sector**
  - **(7) State Enterprises**
- **Joint Sector**
  - **(8) Public Private Organizations**

Let us now study the types of business organizations as given in the above chart.