



INDUSTRIAL ECONOMICS – CHAPTER 2

Meaning of Firm

- A firm is defined as an organization that employs productive resources to obtain products and/or services which are offered in the market with the aim of making a profit.
- While "all firms are organization, not all organizations are firms. An organization is a broader complex social system created by people to cooperate in the achievement of some goal.
- What distinguishes firm from other organization is the aim of obtaining a profit through selling products and services in the market.

Types of Firm

There are several types of firms based on their "ownership structures:

- 1. Individual or Sole proprietorship or sole traders
 - 2. Partnership"
 - 3. Co-operative Society
 - 4. Joint Stock company
 - 5. Public or State undertakings
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1. Individual or Sole Proprietorship

This is the "oldest and simplest form of business organization". It is owned, managed and controlled by one person, and that person is liable for all costs and obligations.

Features:

- **Single ownership:** Owned by an individual.
- **Individual Management and control:** managed and controlled by Sole Proprietor.
- **Individual Financing:** finance mainly by the Sole Proprietor.
- **Individual Accountability:** The Sole Proprietor is sole beneficiary of the profits and "has to bear the losses, if any.
- **Unlimited Liability:** If business assets are not sufficient to meet the business liabilities, his private assets are to be used.

- **Minimum Government Regulation:** There are minimum government regulations to set up such form of organization.

Advantages:

- **Simple Formation:** very easy and simple to for.
- **Independence:** The owner is altogether independent.
- **Quick Decisions:** The sole proprietor takes quick decisions.
- **Complete Control:** The proprietor exercises full control over the functioning and working of the business.
- **Need of Small Capital:** Can start with a comparatively small amount of capital.

Disadvantages:

- **Lack of Division of labor:** less scope for division of labor.
 - **Limited Financial Resources:** The sole proprietor has limited capital and has limited capacity to raise funds.
 - **Limited Managerial Skill:** The sole proprietor has "limited managerial skill.
 - **High Cost of Production:** Cannot reap the benefits of the economies of large scale production.
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2. Partnership

A partnership is an association of persons who agree to combine their financial resources and managerial abilities to carry on a business and share the profits in an agreed ratio.

Features:

- **Two or More Persons:** must be at least two persons to form a partnership.
- **Agreement:** There must be an expressed or implied agreement to form a partnership.
- **Profit Sharing:** There must be a sharing of profits and losses.
- **Joint Ownership and Control:** The firm is owned and controlled jointly by the partners.

Types of partners:

- **Actual or Ostensible:** takes an active part in the conduct of the business.
- **Sleeping or Dormant partner:** does not take an active part in the conduct of the business.
- **Nominal Partner:** lends his name to the firm without having any real interest.
- **Partner in Profit Partner:** share the profits only and not losses.

Advantages:

- **Easy formation:** very easy and simple to form partnership.
- **Careful Decisions:** Decisions are made by all the partners after a great deal of discussion.
- **Division of Work:** Management is divided among different partners.
- **More Capital:** More capital can be invested than in case of individual proprietorship.
- **Division of Labor:** Partners can reap the benefit of labor division.

Disadvantages:

- **Lack of Mutual Confidence:** The success of partnership depends upon the mutual confidence of the partners, which may go on shaking.
 - **Difficult to Separate:** No partner can sell his shares to others according to his wishes.
 - **Delay in Decision:** Sometimes partners do not agree with each other on a particular issue and the decision may not be reached.
 - **Lack of Responsibility:** every man's responsibility is no man's responsibility.
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3. Joint Stock Company

This implies an association of number of persons formed for some common object or objects. It is an "extended form of the partnership business."

Features:

- **An Artificial Person Created by Law:** A company "does not take birth like a natural person but forms in into existence through law.
- **Legal Existence:** The Company is a legal person and it can be sued upon as an individual in the court of law.
- **Limited Liability:** The liability of every shareholder is limited to the extent of his shares.
- **Democratic Management:** "managed by the Board of Directors which is elected by its shareholders.
- **Collective Ownership:** The Company is "owned collectively by all the shareholders to the extent of their shares.

Advantages:

- **Limited Liability:** "The shareholders are not liable to pay anything more than the face value of their shares.

- **Large Capital:** A company can arrange capital in large quantity.
- **Large Scale of Production:** The Company "can reap all the advantages of large scale production.
- **Long Life:** The company "has long life or it's of more permanent nature.
- **Easy to Increase Capital:** It is "easy for a joint stock company to raise more capital... by floating new shares.

Disadvantages:

- **Lengthy and Expensive Procedure for Formation:** heavy fees for the preparation of required documents and for registration is required to be paid.
- **More Government Regulations:** A company is required to comply with various legal formalities at every stage of its working.
- **Separation of Organization and Enterprise:** shareholders are the entrepreneurs and the paid managers are the organizers.
- **Danger of Monopoly:** A joint stock company can create monopoly in the market.
- **Delay in Decision-Making and Action:** The decision making process is time consuming.

4. Public or State Undertakings

These are Industrial and commercial undertakings owned and run by the government.

Advantages:

- **Development of Backward areas:** Extension of public enterprise is essential for the economic reconstruction of the backward areas.
- **Public welfare:** The aim of public enterprises is not to earn profits, but the social or public welfare which promotes national interest.
- **Development of Heavy and Basic Industries:** Private enterprise generally hesitate to participate in capital intensive investments, so public enterprise come to help.
- **Reasonable Prices:** Public enterprises "produce generally of better quality goods and sell them reasonable prices.