December 2020

ECO-01 Business Organisation

Note : Attempt both the Parts 'A' and 'B' as directed.

1. Distinguish between any two of the following : 5+5

(a) Business and profession

Ans:

Business	Profession
Business is an economic activity concerned with the production or purchase and sale of merchandise and rendering of services with the purpose of earning profit.	Profession is a form of economic activities, wherein special skills, knowledge and expertise is required to be applied by the person, in his occupation.
The primary objective of a business is to earn profit.	Profession is aimed at providing services.
A business can be established by the decision of the entrepreneur and fulfilling certain legal formalities.	Profession requires membership of the respective professional body and certificate of practice, for the establishment.
Any person can start a business, there is no minimum qualification to run a venture.	Specialised knowledge of study, training and expertise is the major requirement for the profession.
It requires capital investment according to its size and nature.	Capital requirement is limited. Some amount of capital required for equipment and establishment of office.
Gets profit as a return for the work done by him/her.	Professional gets a fee for the services rendered by him/her.
Transfer of interest is common. By following required legal formalities, business can be transferred to others.	Transferability is not possible as it requires specialised skill and knowledge.
Risk factor is always present in business. There is risk of loss.	Risk factor may or may not be present in a profession. Possibility of not getting enough fee to meet the expenditure on establishment.
Every business advertises its products and services, for the purpose of increasing sales.	Advertisement is strictly prohibited as per professional code of conduct.

(b) Equity shares and debentures

Ans:

Equity Shares	Debentures

Shares are a form of security indicating the ownership in an organisation. Shares are ownership securities.	Debentures refer to a kind of security that indicates debt to a company. Debentures are creditorship securities.
Shares represent the capital of the company.	Debentures represent the debt of the company.
Repayment of capital to shareholders is made after paying off liabilities.	Debentures get priority over shares, and so they are repaid before shares.
Shareholders have a right to participate in the affairs of the company.	Debenture holders can’t participate in the affairs of the company.
Not convertible into debentures	Convertible into shares
Dividend is paid on shares by the company. The rate of dividend is not fixed.	Interest is paid on debentures at a fixed rate.
Dividends can be paid to shareholders only out of profit.	Interest can be paid to debenture holders even if there is no profit.
High degree of risk is borne by the equity shareholders.	Debentures are the debt for the companies, hence debenture holders bear less risk.
The holder of shares is called share holder.	The holder of shares is called debenture holder.

(c) Functional middlemen and merchant middlemen

Ans: Functional middlemen or mercantile agents: A functional Middleman who undertakes specific functions of sale or purchase of goods as agent of the owner without having ownership right. These functional middlemen operate on behalf of owners. They perform a specific function or undertake general functions relating to purchase and sale. These middlemen are also called 'mercantile agents'. Depending on the functions performed, the functional middlemen may be classified into five categories.

i. Factors: A middleman who keeps the goods of others and sells them with the approval of the owner is known as a 'factor'. The goods are normally in his possession or under his control. With the approval of the owner the factor can sell the goods as agent, or sell in his own name, or pledge goods in his possession, or can do all such acts as can be done by the owner of the goods. After the sale of goods, he receives the payment from the buyer. He receives commission at a fixed percentage on sales from his principal.

ii. Brokers: Middlemen who bring together the buyers and sellers and negotiate the terms and conditions oi sale on behalf of either the buyer or seller are known as brokers. When a broker acts on behalf of the buyer, he is known as buying agent. If the owner of goods employs a broker for sale of the goods, the broker is known as a selling agent. For his services, the broker receives a fixed percentage of the value of transaction as brokerage from the employer i.e., either buyer or seller.

iii. Commission Agent: The commission agent is a middleman who sells goods as an agent of the owner. He takes the, possession of the goods, negotiates the terms of sale with the - intending buyers, and arranges transfer of title of the goods to the buyer. If necessary, the -. commission agent also performs various other functions like storage, grading, packaging, etc. For his services, the commission agent receives remuneration from his, principal as a percentage of the value of goods sold.

iv. Del credere Agents: Generally if any mercantile agent sells goods on credit with the approval of the owner, he is not responsible for any loss which may arise due to nonpayment by the buyer. The owner

or principal has to bear the risk of loss on account of such bad debts. When a mercantile agent sells the goods on credit and assumes the risk of bad debts, he is known as a del credere agent. For bearing,such risk of bad debts, additional commission as a fixed percentage of the amount of credit sales is given to him. This additional commission is called del credere commission. In other words, the delcredere agent bears the loss which may arise on account of bad debt and the owner is protected against the loss.

v. Auctioneers: Middlemen appointed as agents to sell goods by auction are known as auctioneers. They assemble goods from different parties and act on their behalf to sell them to intending buyers. The date and time of auction are announced in advance. Goods are displayed for inspection by interested buyers, Bids are then invited by the auctioneer from those present at the time of auction. Sometimes a minimum price is fixed for specific items known as reserve price and bids are not accepted below that reserve price. The goods are sold to the highest bidder. The auctioneer gets commission from the principal (seller) as a percentage on the sale price.

Merchant middlemen : Middlemen who act on their own right buying and selling goods at a profit, tire called merchant middlemen or merchants. They acquire title to the goods and bear the risks of trade besides performing various functions like storing, grading, packing and packaging, etc. Merchant middlemen may be divided into two categories.

i) Wholesale traders ii) Retail traders ,

Merchants who buy goods from producers or manufactures or their agents and sell the same to industrial consumers or retail traders are known as wholesale traders. The middlemen who buy goods from producers or wholesalers and sell the same to ultimate consumers are known as retail traders. Thus, retailers act as the final link in the channel of distribution.

(d) Life insurance and other forms of insurance

Ans: Term of contract: One major distinction between the two is the duration of the policy. Life insurance plans are long-term plans and require policyholders to either pay a lump sum premium, or regular monthly, quarterly, or yearly premiums for a significant amount of time. For example, 15-20 years or up to a lifetime. Other forms of insurance, on the other hand, is a short-term plan that is generally renewed yearly.

Premium payment: The premium for a life insurance policy is paid at regular intervals like monthly, quarterly, or yearly. In contrast, the premium for other types of insurance policy is paid at once, either when the policy is bought or when it is renewed.

Life insurance is an insurance related to human lives. On the other hand, other forms of insurance mostly related to property.

In life insurance, the event (ie., attainment of certain age or death of insured) is certain to happen. On the other hand, the peril may or may not occur in case of other forms of insurance.

Life insurance premiums are generally higher compared to other types of insurance due to the extended duration of coverage and the potential payout upon the policyholder's death. On the other hand, other insurances may have lower premiums but offer benefits tailored to the specific risks they cover.

Insurable interest: Life insurance typically requires an insurable interest, meaning the policyholder must have a financial interest in the insured person's life. This requirement ensures that life insurance is not used for speculative purposes and is generally limited to close family members, business partners, or individuals with a financial dependence on the insured person. In contrast, other types of insurance, like property or casualty insurance, may not have such strict requirements for insurable interest. Life insurance does not work on the principle of indemnity whereas other forms of insurance follow principle of indemnity (compensation in the event of loss or damage).

The benefit of the policy in general insurance is enjoyed by the insured himself. In the case of life insurance, the benefit of the claim goes towards the family member nominated by the policyholder at the time of signing the contract.

2. Write short notes on any two of the following : 5+5

(a) Monopolistic position of public utilities

Ans: Undertakings supplying essential public services by nature assume the position of a monopoly. They do not have competitors. You can take the example of Delhi Electric Supply Company. It does not have any competitors for supplying electricity to the residents of Delhi. If another undertaking is involved in the same operation in the same town, equal amount of money is required which is a waste. To avoid any such wasteful expenditure, monopoly is given to public utilities. However, some public utilities may have a few competitors. Take the case of milk supply in Delhi. Mother Dairy supplies the milk. But Delhi Milk Supply Undertaking or Nanak Milk Supply Company also supplies milk in Delhi. Therefore the position enjoyed by Mother Dairy is semimonopolistic.

(b) Pervasiveness of risks in business

Ans: Different risks pervade all kinds of business activities. Many failures of management can be traced to failure to recognise and deal with risks. Risk prevails in all the following main aspects of business: (1) property and personnel, (2) marketing, (3) finance, (4) production, and (5) environment.

Property and Personnel Risks: Every business firm is confronted by potential loss to its property and personnel through common perils such as fire, explosion, wind storm, flood, theft, business liability damage suits, earth quake and death or disability of its personnel. These perils may cause direct loss by damaging property or killing personnel. Losses may occur to business from the occurrence of some of these perils.

Marketing Risks: Marketing activity includes all those business activities necessary to move goods from producers to consumers. The major functions include buying, selling, transportation and storage. Activities like standarization, market information and research are also other important functions of marketing activities. There is an element of risk in all these activities. For instance, you may not be able to sell your products at the prices you want. Due to market conditions, you may be forced to sell at lower prices and incur losses. Similarly, due to sudden spurt in the raw material prices, your cost of production may go up and you may incur losses. Goods may be stolen, damaged or destroyed in transit from perils for which the transporter is not - liable. Similarly, improper facilities for storage may cause unexpected losses. Normal perils such as fire, floods, storm, explosion, theft, etc., can cause extensive damage to goods in the storage. For instance, the fire due to electric short circuit may cause extensive damage to the goods in the storage.

Financial risks: All business firms borrow money and also extend credit to customers. There is always scope for loss from both credit received as well as credit extended. Bad debts due to insolvency of customers is a continuous problem in business. Similarly, creditors like banks and financial institutions may fail or cancel the loans due to bad business conditions. This can cause financial loss to the firm due to curtailed operations. Similarly, unexpected rise in interest rates on bank loans may reduce profits. Business firms investments in stocks and bonds always face risk.

Production risks: Manufacturing enterprises face the problems such as production losses due to breakdown of machinery, defective products due to faulty machinery or poor quality of raw material, under utilisation of installed capacity, inventory buildup to levels much higher than current demand, improper plant layout, uneconomical plant capacity, etc. Such production risks may be minimized by careful planning.

Environmental Risks: Business environment is a crucial factor for every enterprise. Environmental factors such as competition, changing tastes and preferences of consumers, technological developments, governmental policies, ecological issues, political developments, etc., have lot of impact on each and every business firm. All these environmental problems pose risks to business firms.

(c) Requisites of an ideal medium of advertising

Ans: Requisites of an ideal medium of advertising are:

1) Reach: The medium should be such as to reach the largest possible number of the target audience.

2) Message: It should be possible to convey the message adequately through the medium.

3) Economy: The medium must be economical from the point of view of cost.

4) Flexible: It should provide flexibility of size, design, layout, colour, etc.

5) Scope of repetition: The medium should provide adequate scope for repeating the message, if necessary, at frequent intervals.

6) Effective: The use of the medium should result in achieving the goal of sales promotion.

(d) Retained profits as a source of long-term finance

Ans: Profitable companies do not generally distribute the whole amount of profits as dividend. A certain proportion is transferred to reserves and utilised as additional capital. Thus, the financial needs of a company can be met by retaining a part of the annual profits. This may be regarded as reinvestment of profits or 'ploughing back of profits'. Since retained profits actually belong to the shareholders of the company, these are treated as a part of ownership capital, and may be used to meet long, medium and short-term financial needs. The main advantage is that there is no legal formality involved, nor does the company have to depend on external investors to raise capital. Retention & profit is a sort of self-financing of business. However, only the on-going profitable companies can make use of this source of finance. For profitable companies transfer up to 10% of current profits is legally permitted. A company may transfer more than 10% of profits to reserves provided it fulfils certain conditions laid down in the rules framed under the Companies Act. In short, more than 10% of current profits can be retained only after declaring a minimum rate of dividend consistent with the dividend distributed in the past.

Part—B

Note : Attempt any three of the following questions.

3. “Company form of business organisation is the most ideal form of business organisation suitable for all types of business.” Discuss. 10

Ans: Sole proprietorships and Partnerships have the disadvantages of limited resources, unlimited liability, limited managerial skills, etc. The life and stability of these organisations also depend on the life and stability of the proprietors/partners. Hence, they are not considered suitable for large scale business. Large-scale businesses requires large investment and specialised managerial skills. The element of risk is also very high. This situation is led to the emergence of company form of business organisation. In case of company form of organisation, capital is contributed by not one or two persons but by a number of persons called shareholders. Thus, it is possible to raise large amount of capital. A company form of business organisation is an association of persons registered under Companies Act for carrying on some business. It is called an artificial person as it is created by law, with a distinctive name, a common seal and perpetual succession of members. It can sue and be sued in its own name. The ownership lies with one person only. There are no associates or partners. He invests his own money or borrows from the friends and relatives.

In partnership form of organisation, liability is unlimited. In respect of business debts, each partner has unlimited liability. This means that if the assets of the firms are not sufficient to meet the obligations of the firm, the partners have to pay from their private assets. The creditors can even realise the whole of their dues from one of the partners. Thus, all the partners are jointly and severally liable for all business debts and obligations. Whereas, in company form of organisation, liability is limited. The liability of the members of a company is normally limited by guarantee or by the shares. Members liability is limited to the amount of shares held. Members are not personally liable for the debts of the company. So, personal properties of the members are not liable to be attached for the payment of the company's debts.

Since there is a limit of' maximum partners (20 in non-banking firms and 10 in banking firms), the capital raising capacity of the partnership firms is limited as compared to a joint stock company. Since company form of organisations are allowed to have a large number of shareholders, it is possible to raise capital in large amounts. Whenever new capital is required, it can issue shares and debentures. For this reason, only the company form of organisation is best suited.

In partnership form of organisation, no partner can transfer his interest in a firm without the consent of other partners. In company form of organisation, the members enjoy a statutory right to sell his share to others without the consent of other shareholders.

As a company is an artificial person so that it can enter into contracts in its own name, the members are not held liable for the acts of the company. But in the case of a partnership form of business organisation, a partner can enter into a contract in their own name with the mutual consent of the other partners, and they can also be sued for the acts done by the firm.

In company form of organisation, the membership is very large, so the business risk is divided among the several members of the company. This is an advantage for small investors.

The sudden death, lunacy or insolvency of a partner leads to the dissolution of partnership. This breeds uncertainty in the continuity of a partnership firm. A joint stock company has a continuous existence. Its life is not affected by the death, lunacy, insolvency or retirement of its shareholders or directors. Members may come and go, but the company continues its operations until it is legally dissolved. Partnership form of organisation is managed by all the partners, there is no separate professional managers appointed due to lack of resources. Whereas, company form of organisation is managed by highly professionalised experts and Board of Directors.

Since they are more in number, most of the shareholders of the company may not know each other. We cannot expect that all the shareholders are just and honest to one another. But in the case of partnership, the partners know each other thoroughly. The partnership agreement is based on utmost good faith. So the partners are to be just and honest to one another.

Companies pay income tax at flat rates. There is no provision for slab system in the taxation of companies. As a result, companies pay lower taxes on higher incomes compared to other forms of organisations. Companies also get some tax concessions if they are established in backward areas.

Companies are subject to Government controls and regulations. Their accounts are audited by a chartered accountant and are to be published. This creates confidence in the public about the functioning of the company. Whereas in partnership form of organisation, Since the accounts are not published and publicised, the firm may not be able to command confidence of the public.

4. Explain the factors be kept in mind while determining the capital structure of a company. 10

Ans:

Factors determining the capital structure of a firm are:

1.Nature of the business: If a company is engaged in business activities in which sales are subject to wide fluctuations, it is desirable to have a smaller proportion of borrowed funds. Companies manufacturing televisions, refrigerators, machine tools and capital goods are normally subject to fluctuations in sales from time to time. Companies dealing in essential consumer goods of daily use are products having inelastic demand generally have stable earnings, and thus may depend to a greater extent on borrowed capital.

2. Characteristics of the company: The size of a company as well as its credit standing also determines the extent to which equity or debt capital should be raised. Small firms have to depend more on owners' funds as it is difficult for them to raise long-term loans. This is because investors consider lending to small firms to be riskier. In contrast, large companies must make use of different sources of raising funds as no single source can meet their total financial requirements. Normally investors prefer to lend money to large companies as they believe that their money is safe and the risk is less with big business firms.

3. Cost of finance: Since interest paid on borrowings is chargeable to profits before tax calculation, the cost of debt financing is inevitably lower than the expected rate of earnings (i.e., profitability) on equity capital. Hence, it is always beneficial to raise part of the total financial requirement through long-term loans. With lower cost of debt financing, the overall (average) cost of financing is reduced, and the return on equity capital is higher. This is one of the important determinants of the capital structure.

4. Flexibility of capital structure: The capital structure decision is usually made by management keeping in view their ability to adjust the sources of funds. The scope of changing the capital structure in future happens to be a basic consideration. For instance, in case additional funds are needed, a firm which is already financed with heavy debt may be forced to issue equity shares with a higher cost of finance involved. Or, again if funds raised are to be refunded on account of declining business, a firm may be unable to do so if it earlier relied heavily on equity capital.

5. Availability of cash (cash flow): The ability of a business to discharge its fixed obligations depends essentially on the availability of liquid cash. Profits earned may be adequate to cover the fixed charges arising out of debt, but the firm may not have sufficient cash to pay as the income gets continually invested in the form of more inventory, book debts or even purchase of equipment. Hence, besides profitability, it is necessary to estimate the cash flows before deciding on the proportion of debt in the capital structure.

6. Expected earnings in relation to interest charges: Another factor determining debt-equity ratio is the estimated coverage of interest by profits. If the average earnings of the company are expected to be three to four times the amount of interest payable on borrowed capital, it may be considered safe to raise long-term loans rather than equity capital. Three to four times coverage of interest by earnings is regarded as a reasonable assurance that interest payment would be possible even if profits decline substantially.

7. Effect of debt financing on the earnings per equity share: The effect of debt on the rate of return on equity (or earning per share) is known as 'trading on equity' or 'leverage effect', Thus in business ventures with assured prospect of rising income, there is greater emphasis on debt capital in the capital structure.

8. Management control: Promoters who had major shareholding and control the management of the company take into account the probable effect of raising funds through the Issue of equity shares. Equity shareholders having voting rights can influence the policy decisions of the company or the selection of directors. But the persons who give loans do not have any right to elect directors or to participate in the management of the company. Hence the existing management group, in order to retain their control over management, prefer to raise additional finance through the issue of debentures and preference shares

5. “Advertising is a social waste.” Do you agree with this statement ? Give reasons for your argument. (10)

Ans: Though advertising is one of the most frequently used medium of promotion of goods and services, it attracts lot of criticism. The opponents of advertising say that the expenditure on advertising is a social waste as it adds to the cost, multiplies the needs of people and undermines social values. The proponents, however, argue that advertising is very useful as it increases the reach, brings the pay unit cost of production down and adds to the growth of the economy. It is therefore, important to examine the major criticisms against advertising and see the extent to which these are true. This is taken up as follows:

1. Adds to Cost: The opponents of advertising argue that advertising unnecessarily adds to the cost of product, which is ultimately passed on to the buyers in the form of high prices. An advertisement on TV,

for a few seconds, for example, costs the marketers several lakhs of rupees. Similarly, an advertisement in print media say in a newspaper or a magazine costs the marketers a large amount of money. The money spent adds to the cost, which is an important factor in fixation of the price of a product. True, advertisement of a product costs lot of money but it helps to increase the demand for the product as large number of potential buyers come to know about the availability of the products, its features etc. and are persuaded to buy it. The increased demand leads to higher production, which brings with it the economies of scale. As a result, the per unit cost of production comes down as the total cost is divided by larger number of units. Thus, the expenditure on advertisement adds to the total cost but the per unit cost comes down which in fact lessens the burden of consumers rather than adding to it.

2. Undermines Social Values: Another important criticism of advertising is that it undermines social values and promotes materialism. It breeds discontent among people as they come to know about new products and feel dissatisfied with their present state of affairs. Some advertisements show new life styles, which don't find social approval. This criticism is not entirely true. Advertisement in fact helps buyers by informing them about the new products, which may be improvement over the existing products. If the buyers are not informed about these products, they may be using inefficient products. Further, the job of an advertisement is to inform. The final choice to buy or not to buy anyway rests with the buyers. They will buy if the advertised product satisfies some of their needs. They may be motivated to work harder to be able to purchase these products.

3. Confuses the Buyers: Another criticism against advertisement is that so many products are being advertised which makes similar claims that the buyer gets confused as to which one is true and which one should be relied upon. For example, we may note similar claims of whiteness or stain removing abilities in competing brands of detergent powder or claims of whiteness of tooth or 'feelings of freshness' in competing brands of toothpaste that it is sometimes confusing to us as to which one to buy. The supporters of advertisement, however, argue that we are all rational human beings who make our decisions for purchase of products on factors such as price, style, size, etc. Thus, the buyers can clear their confusion by analysing the information provided on the advertisements and other sources before taking a decision to purchase a product. However, this criticism cannot be completely overruled.

4. Encourages Sale of Inferior Products: Advertising does not distinguish between superior and inferior products and persuades people to purchase even the inferior products. In fact, superiority and inferiority depends on the quality, which is a relative concept. The desired level of quality will depend on the economic status and preferences of the target customers. Advertisements sell products of a given quality and the buyers will buy if it suits their requirements. No advertisement should however, make false claim about the quality of a product. If a firm makes a false claims it can be prosecuted for the same.

5. Some Advertisements are in Bad Taste: Another criticism against advertising is that some advertisements are in bad taste. These show something which in not approved by some people say advertisements showing women dancing when not required or running after a man because he is wearing a particular suit or using a particular perfume are certainly not good. Some advertisements distort the relationship like employer employee and are quite offensive.

6.Advertising leads to monopoly: Small competitors find it difficult to enter the market due to advertising. This is because large firms create hurdles in their way.

7.Advertising causes undesirable social effects: Certain social effects can be. there due to advertising like it influences the materialistic values and life styles of people in society, certain sex and, horror appeals are used in order to draw the consumers attention, it creates frustration and disappointment when a person cannot purchase and enjoy a particular product.

8. Advertising results in inefficient resource allocation: Advertisements are intended not so much for the benefit of consumers. They are mainly directed to influence the consumer demand to fit whatever has been produced. In other words, advertisements are aimed mainly to change the tastes of people so that they will buy whatever is manufactured. This leads to distortion in consumption expenditure and increases the producers market power. Thus, advertising indirectly determines what people should consume. In this process productive resources i.e., land, labour and capital, may not be used in the best interest of the society.

9. Advertising may act against the freedom of press: Mass media earn huge income from advertisements. If the media are dependent on income from advertisements sponsored by few large business firms, it may be difficult to disseminate information in public interest when it is unfavourable to those big business firms. Big sponsoring firms can threaten the media owners by refusing their advertisements and dictate what media have to do. Thus, the financial dependence of media on advertisements may act against the freedom of press.

6. Discuss various modes of creating charge by banks on the tangible assets of the borrowers. 10

Ans: The important methods of creating a charge are: (1) pledge, (2) hypothecation, and (3) mortgage.

(1) Pledge: Section 172 of the Indian Contract Act defines pledge as '&a bailment of goods as security for payment of a debt or performance of a promise". A pledge is a contract whereby a borrower delivers his movable property to the lender as a security for the loan on the understanding that the property pledged will be returned to the borrower on repayment of the debt. The borrower who pledges the property is called the 'pledged' or 'pawner' and the person with whom the property is pledged is known as 'pledgee' or 'pawnee'. Delivery of goods and return of goods are the two essential features of pledge. Delivery of goods may be either physical delivery or constructive (symbolic) delivery. When the pledgee puts his own lock on the godown or when the keys of the lock are handed over to the bank, it amounts to delivery of goods. Similarly, handing over the duly endorsed documents of title to goods like railway receipt, bill of lading, etc., amount to delivery of goods. While accepting a pledge as a charge, the bank should ensure that the contract is in writing to minimise the misunderstanding of the terms. The contract should be complete in all respects and should incorporate all the usual clauses of pledge. It is advisable for the bank to get a declaration from the boirower to the effect the goods deposited with the bank are left as a security for the advance. The bank should see that the borrower has a valid title to the property pledged. The bank should ensure that the goods are kept safely in the godown. It is desirable that the bank should ensure goods against theft, fire, riot, etc. When goods are pledged, only the possession over the goods is given and not the ownership. The pledger or the borrower continues to be the owner of the property. If the borrower failed to repay the loan in time, the bank has a right to file a suit against the borrower for the recovery of the amount, and retain the goods as collateral security. But since this is a lengthy process, the banks are given the right to sell the pledged goods and recover their money. But before selling the goods, the bank must give a reasonable notice to the

borrower about his intention to sell the goods. If the proceeds of sale are less than the amount due, the borrower is still liable to pay the balance. But if the proceeds of sale is in excess of the amount due, the bank has to pay the surplus amount to the borrower. In case the goods are sold without giving a reasonable notice to the borrower, the sale cannot be set aside, but the bank will become liable to the borrower for damages. For securing a charge on the property, the method of pledging is very simple and therefore, it is very popular. It should also be noted that the right to retain the goods pledged is applicable only in case of a particular debt for which the goods are pledged. The bank has no right to retain the security, as security for other debts owned by the borrower.

(2) Hypothecation: Hypothecation is a mode of creating charge on goods or related documents without the surrender of possession of goods. According to Prof. Herbert Hart, "Hypothecation is a legal transaction whereby goods may be made available as security for a debt without transferring either the property or the possession to the lender". Hypothecation is resorted to such cases where transfer of possession of the property from the borrower to the creditor is either impracticable or inconvenient. For example, if the borrower wants to borrow on the security of motor vehicle, which is being used as a taxi, it shall not be advisable to pledge the vehicle with the bank, as it will deprive him of his livelihood. In the case of hypothecation, an equitable charge is created on the goods for the amount of debt but the hypothecated goods actually remain in the physical possession of the borrower. The borrower who hypothecates the goods is known as 'hypothecator' and the lender is termed as 'hypothecatee'. Hypothecation is done by the borrower by executing a document called a 'letter of hypothecation' in favour of the lender. In this letter it is stated that the said goods or property are at the order and disposition of the lender until the debt is cleared. It also empowers the lender to sell the hypothecated property in the event of default or repayment by the borrower. As the lzypothecated goods remain in the possession of the borrower, there is considerable scope for fraud. The same goods may be hypothecated with another person. It is a risky method no doubt. That is why this facility is granted to parties of unquestionable integrity and honesty. Even then the banker should obtain a declaration from the borrower to the effect that the goods are not hypothecated earlier with some other lender and that the borrower has a clear title to the property hypothecated. The bank should carry out regular inspection and physical verification of the hypothecated goods.

(3) Mortgage: When immovable property like land and building is offered as security for debt, a charge is I created thereon by means of a mortgage. A mortgage is the transfer of the interest in a specific immovable property by one person to another for the purpose of securing an advance of money. The transferor is called 'mortgagor' and the transferee is known as 'mortgagee'. The advance of money in respect of which the mortgage is effected is called the ‘mortgage money' and the instrument by which the mortgage is effected is called the 'mortgage deed'. In a mortgage, the possession of the property need not always be transferred to the mortgagee. Usually, it remains with the mortgagor. Since the mortgagee gets the interest in the property, he has a right to sell of the property and recover his loan. When the borrower ' repays the amount of loan together with interest, the interest in the property is re-conveyed to the mortgagor. While accepting a mortgage as a charge, the bank should ensure that the borrower has a valid title to the property and this can be done by examining the original title deeds. The bank must not part with the title deeds to the borrower when the mortgage is pending. If the advance

against mortgage is given to a joint stock company, then the charge should be registered with the Registrar of Companies within 30 days of the creation of the charge. The mortgaged property should be inspected periodically to ensure that it is in good condition. If the property mortgaged is building, the bank should ensure that it is insured against fire, riot etc. There are several forms of mortgage. They are (i) simple mortgage; (ii) Usufructuary mortgage; (iii) English mortgage; (iv) Mortgage by conditional sale; (v) Equitable mortgage or mortgage by deposit of title deeds and (vi) anomalous mortgage.

7. Why is it necessary for the Government to directly participate in business ? Discuss. 10

Ans: The government controls the private enterprises on one hand and directly participate in the business on the other. Government today is engaged in various types of business undertakings. There are several types of services which are provided by Governmnent organisations such as electricity, water, postal, telecommunications, transport services, etc.. Besides these organisations, there are many manufacturing industries owned and managed by government. They produce steel, locomotives, machine tools, watches, railway coaches. telephone equipment, and so on. Government undertakings are also involved in the supply of consumer goods like milk (through government milk schemes), bread (Modem Bakeries), cloth (National Textile Corporation), etc.

The reasons for the direct participation of government in business and industry may be divided into three categories:

i) basic reasons

ii) ideological reasons

iii) specific reasons.

i) Basic reasons: The government of India was rightly convinced that political independence without economic independence would not have much meaning. It was, therefore, decided to industrialise the country in a big way as early as possible.

The government felt that if the private sector was to take the initiative. it would take an unduly long time to achieve this objective of rapid industrialisation. It was so because the private enterprises lacked adequate entrepreneurship and resources to start large scale ventures.

The government encouraged private enterprises to set up new industries, but also, went into industry in a big way.

It was decided to establish steel plants. fertilizer factories and other units necessary for industrial and agricultural growth. The following is a list of some major enterprises and power projects set up by the government within a decade of Independence- Steel Plants at Rourkela, Bhilai and Durgapur, Indian Telephone Industries.

The intention of the government was to have economic self-reliance in as many areas and as early as possible.

ii) Ideological reasons: Apart from the economic and social consideration, the government had strong ideological commitment to the philosophy of public ownership of the means of production.

iii) Specific reasons: There are many other reasons for the government to participate in business. These are specific to a particular decision. Some of these are listed below.

* Air Transport Business: Till 1953, there were many private air companies in the country. Most of these were financially unsound and had no money to invest in modem and costly aeroplanes, The air transport is of strategic importance to the country. The government, therefore, nationalised nine air companies and created Indian Airlines Corporation and Air India International Corporation in 1953.

* Insurance Business: Today, the whole of insurance business is with the government. The life insurance business is operated through the Life Insurance Corporation of India and other types of insurance business through the General Insurance Corporation of India and its four subsidiary companies. The government went into the life insurance business in 1956 nationalising scores of private companies which were not fulfilling the main objective of the life insurance business, namely, i) effective mobilisation of the people's savings, ii) spreading the message of insurance as far and as wide as possible, and iii) using the insurance funds for economic development.

* Commercial Banks: The government today is in the banking business in a big way. Over 90% of commercial banking is in the hands of the government. The government rightly wanted the banking system to serve the developmental needs of the economy in conformity with national policy and objectives. It also wanted the banks to have new criteria for advancing loans in order to benefit the weaker sections of the society.

* Coal Industry: The coking coal mines were nationalised in 1971. It was done because coking coal which is essential for production of iron and steel has very limited reserves in the country. The private sector was mining this fast depleting and scarce natural resources in a very wasteful manner. Other coal mines were also nationalised in 1973. The reasons for this were: i) the private sector owners did not have the necessary funds required for increasing the coal production, ii) the coal which is a scarce natural resource was being mined in a very unscientific way, and iii) the private coal miners were greatly exploiting the labour employed in the mines.

* Oil Industry: In the 1970's the foreign oil companies Burmah Shell, Caltex and Esso were nationalised. Here the objective was that the government should have control over a critical and strategically important resource like oil.

* Various Other Types of Business: There is yet another important reason for the government going into business of various types. Over one hundred cotton textile mills and dozens of engineering and other enterprises have been taken over by the government since Independence. This is done because the government cannot afford to lose production capacity which exists in the units which become sick and which the private sector wants to close down.

From the above, we can conclude the reasons for participation of Government as:

i) The government's role in business in India is greatly justified by economic and social reasons.

ii) Had the government not initiated a large number of industrial activities, the Indian economy would never have got the sound base and self-reliance which it has today.

iii) A large number of enterprises have been forced on the government when they became sick and they could not be allowed to be closed down due to social and economic reasons.

iv) There is an element of ideology in the role which the government has in business today. Had the ideology not been there, the government would have disengaged itself from at least some of its business activities after completing its role as path finder or initiator.

v) The government continues to be in business in a big way because of ideological as well as economic and social considerations.