**Unit-4**

**Sole Proprietorship**

A **sole proprietorship**, also known as the **sole trader** or simply a **proprietorship**, is a type of [business entity](http://en.wikipedia.org/wiki/Business_entity) that is owned and run by one individual and in which there is no legal distinction between the owner and the business. It is the most common type of business. For example- barbers who own their shops, auto mechanics who are self-employed, a gardener who mows lawns for a fee, repairing windows, plumbing and real estate agents who work for themselves are common examples of single proprietors. It is easy to organize the needs only small amount of capital needs to start and run a business. The whole profit goes in the pocket of sole trader. Decisions can be made quickly and not much of legal formalities to set up this kind of business. There is secrecy in sole proprietorship.

 However there are some drawback also It has unlimited responsibility for all losses and debts. If the firm fails, creditors may force the sale of the proprietor's personal property as well as their business property to satisfy their claim Every asset of the business is owned by the proprietor and all debts of the business are the proprietor's. He has limited resources. Banks are reluctant to grant loans to single proprietorship considering its small assets and high mortality rate. When the owner dies, the continuation of the business is difficult, because a new owner must typically accept all liabilities of the business.

**Partnership**

 A type of business organization in which two or more individuals pool money, skills, and other resources, and share profit and loss in accordance with the terms of the partnership agreement. A partnership is generally easier to form, manage and run. They are less strictly regulated than companies, in terms of the laws governing the formation. The basic motive of the formation of partnership is to earn profit. This profit is distributed among the partners according to agreed proportion. If there is loss it will be sustained by all partners except the minor. There should be more than one person to form a partnership. But there is restriction for the maximum number of partners. In case of ordinary business, the partners must not exceed 20 and in case of banking must not exceed 10 (before nationalization). Due to the nature of the business, the partners will fund the business with start up capital. This means that the more partners there are, the more money they can put into the business, which will allow better flexibility and more potential for growth. It also means more potential profit, which will be equally shared between the partners. Partners share the decision making and can help each other out when they need to. More partners mean more brains that can be picked for business ideas and for the solving of problems that the business encounters.

**Partnership Deed**

 A partnership deed is a legally binding document between partners who own a business together. The document usually describes how the business will be run as well as the rights and duties of the partners. A well drawn up deed document should include capital contributed by both parties, sharing of profits, working arrangements and how change of partnership should take place.

**Disadvantages of partnership**

• Business partners are jointly and individually liable for the actions of the other partners.

• Profits must be shared with others. You have to decide on how you value each other’s time and skills. What happens if one partner can put in less time due to personal circumstances?

• Since decisions are shared, disagreements can occur. A partnership is for the long term, and expectations and situations can change, which can lead to dramatic and traumatic split ups.

• The partnership may have a limited life; it may end upon the withdrawal or death of a partner.

• A partnership usually has limitations that keep it from becoming a large business.

• You have to consult your partner and negotiate more as you cannot make decisions by yourself. You therefore need to be more flexible.

• A major disadvantage of a partnership is unlimited liability. General partners are liable without limit for all debts contracted and errors made by the partnership. For example, if you own only 1 percent of the partnership and the business fails, you will be called upon to pay 1 percent of the bills and the other partners will be assessed their 99 percent. However, if your partners cannot pay, you may be called upon to pay all the debts even if you must sell off all your possessions to do so. This makes partnerships too risky for most situations.

**Limited Partnership**

Two or more partners united to conduct a business jointly, and in which one or more of the partners is liable only to the extent of the amount of money that partner has invested. Limited partners do not receive dividends, but enjoy direct access to the flow of income and expenses.

In the [United States](http://en.wikipedia.org/wiki/United_States), the LP organization is most common among law firms, accounting firms, [film production companies](http://en.wikipedia.org/wiki/Film_industry), finance firms and real estate investment projects or in types of businesses that focus on a single or limited-term project. [Private equity](http://en.wikipedia.org/wiki/Private_equity) companies almost exclusively use a combination of general and limited partners for their investment funds. Well-known limited partnerships include [Enterprise Products](http://en.wikipedia.org/wiki/Enterprise_Products) and [Blackstone Group](http://en.wikipedia.org/wiki/Blackstone_Group) (both of which are [public companies](http://en.wikipedia.org/wiki/Public_company)), and [Bloomberg L.P.](http://en.wikipedia.org/wiki/Bloomberg_L.P.) (a [private company](http://en.wikipedia.org/wiki/Private_company)).

Company

A company can be defined as an "artificial person", invisible, intangible, created by or under law, with a discrete [legal entity](http://en.wikipedia.org/wiki/Legal_personality), [perpetual succession](http://en.wikipedia.org/wiki/Perpetual_succession) and a [common seal](http://en.wikipedia.org/wiki/Company_seal). It is not affected by the death, insanity or [insolvency](http://en.wikipedia.org/wiki/Insolvency) of an individual member. The company needs to be registered with the Registrar of Companies in a country. A company has limited liability. If the company runs into losses the company need to pay its debtors, the amount of loss beard by each shareholder will be the amount of shares held by them.

Shareholders of companies they choose board of directors to run the company. Director refers to a rank in [management](http://en.wikipedia.org/wiki/Management). A director is a person who leads or supervises a certain area of a company, program, or project. [Companies](http://en.wikipedia.org/wiki/Corporation) that use this [title](http://en.wikipedia.org/wiki/Corporate_title) often have many directors spread throughout different categories (e.g. director of [human resources](http://en.wikipedia.org/wiki/Human_resources)). The director usually reports directly to a [Vice President](http://en.wikipedia.org/wiki/Vice_President) or to the [CEO](http://en.wikipedia.org/wiki/Chief_executive_officer). CEO is responsible for day-to-day running of business whereas the Chairman runs and represents the company.

Private Company

A private company is a separate legal entity distinct from its shareholders. A private company is liable for its debts and creditors cannot sue the shareholders for the payment of these debts. A private company needs to be registered with the Registrar of Companies in a country, so lot of paperwork involved. . A private company can have up to 50 shareholders. Other companies can hold shares in a company. The stocks can be issued and the company can have shareholders but these shares are restricted only to the company and company holders and not given out for the public. Private companies are mostly family business( all or majority of the shareholders are of family or friends)

At the start of a [business](http://en.wikipedia.org/wiki/Business), [owners](http://en.wikipedia.org/wiki/Owner) put some funding into the business to finance [operations](http://en.wikipedia.org/wiki/Business_operations). This creates a liability on the business in the shape of [capital](http://en.wikipedia.org/wiki/Share_capital) as the business is a separate entity from its owners. The finance from shareholders is called the equity. The shareholders they receive return on their investments in the form of dividend.

Private company can also borrow money from banks and other lenders which is called loan capital. Equity is paid off after paying all the liabilities of the company.

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|  | **Hilton group, Amway, Earnest and Young, Mars** | **, Publix Supermarket, Mars** |  |  |  |

But there are many disadvantages, including the costs to register. The structure of a company is more complex because it must have separate ownership and management, the shareholders own it and the board of directors manages it.

The decision making process is complex because there are prescribed general meetings, notice periods and formalities for the passing of resolutions. The law requires a company to audit its books once a year. .

Shareholder need to take permission from the board of directors to sell their shares.

The law strictly governs the conduct and duties of company directors and officers. For example, not keeping minutes of board meetings or not holding an annual general meeting is illegal. If you are going to register a company, make sure that you are aware of all the legal requirements that must be complied with.

Public Company

A company that has issued securities through an initial public offering (IPO) and is traded on at least one stock exchange or in the over the counter market. Although a small percentage of shares may be initially "floated" to the public, the act of becoming a public company allows the market to determine the value of the entire company through daily trading. Limited companies which can sell share on the stock exchange are Public Limited companies. These companies usually write PLC after their names. Minimum value of shares to be issued (in UK) is £50,000.

**Advantages**

* There is limited liability for the shareholders.
* The business has separate legal entity. There is continuity even if any of the shareholders die.
* These businesses can raise large capital sum as there is no limit to the number of shareholders.
* The shares of the business are freely transferable providing more liquidity to its shareholders .

**Disadvantages**

* There are lot of legal formalities required for forming a public limited company. It is costly and time consuming.
* In order to protect the interest of the ordinary investor there are strict controls and regulations to comply. These companies have to publish their accounts.
* The original owners may lose control.
* Public Limited companies are huge in size and may face management problems such as slow decision making and industrial relations problems.

**Multinational Companies**

A multinational corporation (MNC) or multinational enterprise (MNE)[[1]](http://en.wikipedia.org/wiki/Multinational_corporation%22%20%5Cl%20%22cite_note-pitelis-1) is a [corporation](http://en.wikipedia.org/wiki/Corporation) that is registered in more than one country or that has operations in more than one country. It is a large corporation which both produces and sells goods or services in various countries.[[2]](http://en.wikipedia.org/wiki/Multinational_corporation#cite_note-2) It can also be referred to as an international corporation.

They play an important role in [globalization](http://en.wikipedia.org/wiki/Globalization). MNC's directly and indirectly help both the home country and the host country.

**Advantages of MNC's for the host country**

MNC's help the host country in the following ways

1. The investment level, employment level, and income level of the host country increases due to the operation of MNC's.

2. The industries of host country get latest technology from foreign countries through MNC's.

3. The host country's business also gets management expertise from MNC's.

4. The domestic traders and market intermediaries of the host country gets increased business from the operation of MNC's.

5. MNC's break protectionalism, curb local monopolies, create competition among domestic companies and thus enhance their competitiveness.

6. Domestic industries can make use of R and D outcomes of MNC's.

7. The host country can reduce imports and increase exports due to goods produced by MNC's in the host country. This helps to improve balance of payment.

8. Level of industrial and economic development increases due to the growth of MNC's in the host country.

**Disadvantages of MNC's for the host country**

1. MNC's may transfer technology which has become outdated in the home country.

2. As MNC's do not operate within the national autonomy, they may pose a threat to the economic and political sovereignty of host countries.

3. MNC's may kill the domestic industry by monopolising the host country's market.

4. In order to make profit, MNC's may use natural resources of the home country indiscriminately and cause depletion of the resources.

5. A large sums of money flows to foreign countries in terms of payments towards profits, dividends and royalty.

**Advantages of MNC's for the home country**

MNC's home country has the following advantages.

1. MNC's create opportunities for marketing the products produced in the home country throughout the world.

2. They create employment opportunities to the people of home country both at home and abroad.

3. It gives a boost to the industrial activities of home country.

4. MNC's help to maintain favourable balance of payment of the home country in the long run.

5. Home country can also get the benefit of foreign culture brought by MNC's.

**Disadvantages of MNC's for the home country**

1. MNC's transfer the capital from the home country to various host countries causing unfavourable balance of payment.

2. MNC's may not create employment opportunities to the people of home country if it adopts geocentric approach.

3. As investments in foreign countries is more profitable, MNC's may neglect the home countries industrial and economic development.

**Applicability to particular business**

MNC's is suitable in the following cases.

1. Where the Government wants to avail of foreign technology and foreign capital e.g. Maruti Udyog Limited, Hind lever, Philips, HP, Honeywell etc.

2. Where it is desirable in the national interest to increase employment opportunities in the country e.g., Hindustan Lever.

3. Where foreign management expertise is needed e.g. Honeywell, Samsung, LG Electronics etc.

4. Where it is desirable to diversify activities into untapped and priority areas like core and infrastructure industries, e.g. ITC is more acceptable to Indians L&T etc.

5. Pharmaceutical industries e.g. Glaxo, Bayer etc.

**Cooperatives**

A cooperative is a business or organization owned by and operated for the benefit of those using its services. Profits and earnings generated by the cooperative are distributed among the members, also known as user-owners

There are different types of cooperatives but 3 most common cooperatives are :

#### Producer-Owned Cooperatives

Producer cooperatives are **owned by producers of farm commodities or crafts that band together to process and/or market their products**. Purchasing or shared services cooperatives are cooperatives whose members are businesses that join to improve their performance and competitiveness. This form of co-op is most common in agriculture, where farmers often must band together to survive in an industry that is increasingly industrial and centralized. Before cooperatives were organized, farmers were often trapped in a situation in which processors could dictate the prices paid for crops. Get more [details and examples](http://www.ncba.coop/ncba/about-co-ops/co-op-types/producer-cooperatives) of producer-owned cooperatives.

**Farming cooperatives**

An agricultural cooperative, also known as a farmers' co-op, is a [cooperative](http://en.wikipedia.org/wiki/Cooperative) where [farmers](http://en.wikipedia.org/wiki/Farmer) pool their resources in certain areas of activity. A broad typology of agricultural cooperatives distinguishes between *agricultural service cooperatives*, which provide various services to their individually farming members, and *agricultural production cooperatives*, where production resources (land, machinery) are pooled and members farm jointly.

There are two primary types of agricultural service cooperatives, *supply cooperative* and *marketing cooperative*. Supply cooperatives supply their members with inputs for agricultural production, including [seeds](http://en.wikipedia.org/wiki/Seeds), [fertilizers](http://en.wikipedia.org/wiki/Fertilizers), [fuel](http://en.wikipedia.org/wiki/Fuel), and [machinery services](http://en.wikipedia.org/wiki/Agricultural_machinery). Marketing cooperatives are established by farmers to undertake transportation, packaging, distribution, and [marketing](http://en.wikipedia.org/wiki/Agricultural_marketing) of farm products (both crop and livestock). Farmers also widely rely on [credit cooperatives](http://en.wikipedia.org/wiki/Credit_union) as a source of financing for both working capital and investments.

**Retail Cooperatives**

A retailers' cooperative is a type of [cooperative](http://en.wikipedia.org/wiki/Cooperative) which employs [economies of scale](http://en.wikipedia.org/wiki/Economies_of_scale) on behalf of its [retailer](http://en.wikipedia.org/wiki/Retailing) members.[[1]](http://en.wikipedia.org/wiki/Retailers%27_cooperative#cite_note-1) Retailers' cooperatives use their [purchasing power](http://en.wikipedia.org/wiki/Purchasing_power) to acquire discounts from [manufacturers](http://en.wikipedia.org/wiki/Manufacturer) and often share [marketing](http://en.wikipedia.org/wiki/Marketing) expenses. A retailers' cooperative is essentially a group of independently owned businesses that pool their resources to purchase in bulk, usually by establishing a central buying organization, and engage in joint promotion efforts.[[2]](http://en.wikipedia.org/wiki/Retailers%27_cooperative#cite_note-2) It is common for locally owned [grocery stores](http://en.wikipedia.org/wiki/Supermarket), [hardware stores](http://en.wikipedia.org/wiki/Hardware_store) and [pharmacies](http://en.wikipedia.org/wiki/Pharmacy) to participate in retailers' cooperatives.

Retailers' cooperatives are governed by democratic member control, which generally means one vote per member. Some firms, such as [E. Lechers](http://en.wikipedia.org/wiki/E._Leclerc), are able to make decisions in this fashion, with each member business only receiving one vote.[[3]](http://en.wikipedia.org/wiki/Retailers%27_cooperative#cite_note-3) For many retailer co-ops, however, it is difficult to achieve a democratic standard. The owners of cooperative members usually pay minimum subscription.

**Public Corporation**

The public sector refers to the part of the economy concerned with providing basic government services. The composition of the public sector varies by country, but in most countries the public sector includes such services as the [police](http://en.wikipedia.org/wiki/Police), military, [public roads](http://en.wikipedia.org/wiki/Public_roads), [public transit](http://en.wikipedia.org/wiki/Public_transit), primary education and healthcare for the poor. The public sector might provide services that non-payer cannot be excluded from (such as street lighting), services which benefit all of society rather than just the individual who uses the service (such as [public education](http://en.wikipedia.org/wiki/Public_education)), and services that encourage equal opportunity. They hire experts to run these corporations. For day to day decisions the management takes decision but for forming a public corporation bill has to be passed in parliament.

**Advantages**

* Essential services are provided.
* Everyone shares in the profit from public ownership.
* Wasteful duplication of services is eliminated.
* Planning can be co-ordinated through central control.

**Disadvantages**

* Inefficiency results due to the size of the organisation.
* There is a lack of incentive for employees to perform if there is no share in the profit or there is an absence of other motivators such as productivity bonuses - accelerated promotion; (this factor can also apply in the private sector if the employee is not given any incentive to perform).
* Losses must be met by the taxpayer.
* Political interference can occur.
* They interfere with the free market forces.
* There may be difficulties in finding someone to deal with complaints, though this factor is applicable to any large organisation.

Business Growth

The process of improving some measures of an enterprise’s success. Business growth can be achieved either by boosting the top line or revenue with the greater product sales or service income, or by increasing the bottom line or profitability of the operation by minimising costs. Expansion is among any business owner's top priorities. Growing your business is a big step that you should research and plan to ensure your business is sustainable. It is far better not to take on any new business than to take it on and find that you cannot finish it successfully

Growth means that the business is becoming larger, this may be an objective for the business. It can grow in a number of ways;

**1. INTERNAL GROWTH**

This means that it grows without joining with another business. It could
• build new premises
• ‘take on’ more employees

**2. EXTERNAL GROWTH**

In this case it has some involvement with another business

a) MERGER

Two firms join together and have equal ownership e.g. Lloyds and TSB merge to create Lloyds TSB bank.

b) TAKEOVER

One firm takes over another firm and has the ownership of that business. It is probably against the wishes of the other business. e.g. Lloyds could takeover TSB. It would probably still be called Lloyds but it would also own TSB.

**BENEFITS OF GROWTH**

• Increased profits
• Increased market share
• Gain new ideas from the other business
• Avoid having to compete with the other business
• Gain from economies of scale (page)
• The new business may not need all of the workers. They could remove some workers to become efficient and make more profit

## Common problems caused by rapid growth

* You could outgrow your premises in the short-term. There may not be enough space for everyone to work efficiently.
* Morale may drop if staff cannot cope with the extra work. Productivity can decrease.
* There may be a shortage of cash to meet expansion costs. Taking on more and more work to generate more income places additional pressure on your premises and staff.
* Management may be under pressure, operating reactively rather than proactively.
* The quality of your products and services could drop, causing an increase in consumer complaints. You may even lose customers to your competitors.
* Staff turnover may increase due to heavy workloads. Vital knowledge could be lost as staff leave. Hiring and training new staff takes time and money.
* Your business may lose touch with competitors' activities.

**Demand for factors of production**

The demand for factors of production is derived in turn from the demand for the products these factors are used to produce. Factors of production are demanded as a combination because they are required to work together. Buyer chooses the best combinations of factors considering their relative prices.

A labour-intensive industry requires a large amount of labour to produce its goods or services compare to the amount of capital employed.

A capital-intensive industry requires a large amount of capital to produce its goods or services compare to the amount of labour employed.

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**Fixed and Variable costs**

**Fixed Costs**

A cost that does not change with an increase or decrease in the amount of goods or services produced such as depreciation, insurance, [interest](http://www.businessdictionary.com/definition/interest.html), [rent](http://www.businessdictionary.com/definition/rent.html), [salaries](http://www.businessdictionary.com/definition/salary.html), and [wages](http://www.businessdictionary.com/definition/wages.html).

While in [practice](http://www.businessdictionary.com/definition/practice.html), all [costs](http://www.businessdictionary.com/definition/costs.html) vary [over time](http://www.businessdictionary.com/definition/overtime.html) and no cost is a purely fixed cost, the [concept](http://www.businessdictionary.com/definition/concept.html) of fixed costs is necessary [in short](http://www.businessdictionary.com/definition/in-short.html) term [cost accounting](http://www.businessdictionary.com/definition/cost-accounting.html). [Organizations](http://www.businessdictionary.com/definition/organization.html) with [high](http://www.businessdictionary.com/definition/high.html) fixed costs are significantly different from those with high [variable costs](http://www.businessdictionary.com/definition/variable-cost.html). This difference affects the [financial structure](http://www.businessdictionary.com/definition/financial-structure.html) of the organization as well as its pricing and [profits](http://www.businessdictionary.com/definition/profit.html).



**Variable Costs**

Variable costs are costs that change in proportion to the good or service that a business produces. Variable costs include [raw material](http://www.businessdictionary.com/definition/raw-material.html), energy usage, labour, distribution costs, etc. [Companies](http://www.businessdictionary.com/definition/company.html) with [high](http://www.businessdictionary.com/definition/high.html) variable costs are significantly different from those with high [fixed costs](http://www.businessdictionary.com/definition/fixed-cost.html). This difference affects the [financial structure](http://www.businessdictionary.com/definition/financial-structure.html) of the company as well as its pricing and [profits](http://www.businessdictionary.com/definition/profit.html).

**Average Fixed Costs**

In economics, average fixed cost (AFC) is the [fixed costs](http://en.wikipedia.org/wiki/Fixed_cost) of production (FC) divided by the quantity (Q) of output produced. Fixed costs are those costs that must be incurred in fixed quantity regardless of the level of output produced. Average fixed cost is a per-unit-of-output measure of fixed costs. As the total number of units of the good produced increases, the average fixed cost decreases because the same amount of fixed costs is being spread over a larger number of units of output



 

 **Average Variable Costs**

In economics, **average variable cost** (AVC) is a firm's variable cost (labour, electricity, etc.) divided by the quantity (Q) of output produced. Variable costs are those costs which vary with output.



where VC = variable cost, AVC = average variable cost, and Q = quantity of output produced.



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AVC initially falls with more efficient use of factors of production. Once resources are combined less efficiently, they start to rise again.

**Optimum output**

The lowest point on the average cost curve shows the point at which the business is combining its resources most efficiently.

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**Total Cost**

**Total cost** (TC) describes the total cost of production and is made up of variable costs, which vary according to the quantity of a good produced and include inputs such as labor and raw materials, plus fixed costs, which are independent of the quantity of a good produced and include inputs (capital) that cannot be varied in the short term, such as buildings and machinery. Total cost rises with output. Total Cost is calculated by adding together all the costs at each level of output.

**Revenue**

Revenue is the sum of money that a business receives from making sales. Revenue increases with the quantity of increase in sales. In many countries, revenue is referred to as turnover. Some companies receive revenue from interest, royalties, or other fees.

Why do small firms exists

Despite the growth of large scale industry, small business has survived and progressed because it has its won area of operations. Several factors make the establishment and growth of small business necessary.

These factors are described below:

**1. Limited Demand:** The demand for certain products is local and seasonal. In such cases, large scale operations are not economical and small firms are required. Brick kilns, hair0cutting saloons, restaurants, etc, are examples of such cases. In case of perishable goods also, size of firms tends to be small. In certain cases, the nature of production process favors small units.  **2. Specialized Service:** When an enterprise supplies Specialized services, small scale firms are more suitable. Beauty parlors, interior decorators, tailoring shops, are examples of this type. A small firm can understand its customers and can provide personal attention which may not be possible in a large scale enterprise. Similarly, firms providing professional services like eye clinic, tax consultancy, chartered accountancy etc, are also organised as small scale because they must maintain personal touch with their clients. Thus, small firms are required to cater to individual tastes and fashions and to render personalized services to consumers.

**4. Employee Relations:** Small scale units are necessary when close rapport with employees is required to supply goods of special quality to the customers. In a small firm the owner himself acts as the manger and the number of employees is limited. Theretofore, he can fully understand their needs can create close mutual understanding with them. As a result employees will always be ready to carry out changes in the production and distribution systems whenever it is necessary for serving the customer. Employer-employee relations in small enterprises are more harmonious due to their small size and personal character. Imperfections in the labour market also help small firms to survive. These firms operate in areas of unorganized cheap labour so that pressure on prices is easily passed on to wages.

**5. Introduction of New Products:** Before starting the production of a new product on commercial scale, it is always desirable to test it in the market,. In the initial stag, the requirements of customers and management are uncertain and unknown. Therefore, operations are usually carried on small scale when new products or ideas are being introduced in the market. This also helps to reduce the risks.

**6. Direct Motivation:** Small scale enterprises foster in individual initiative and skill. The identity of ownership and management serves to curb misconduct as mistakes bear directly on one's property and income. There is maximum incentive to put the resources to best use because the resulting gains accrue directly to the owner.

**7. Human inertia:** Many businessmen do not want to expand their business due to fear of loss of freedom. Growth may involve more work and worry. People who want to lead a comfortable and simple life many be satisfied with small size of business.

**8. Shield to big business:** Many small firms serve as ancillary units or feeders to large firms. Such units also provide a training ground for entrepreneurs. Small firms also provide some guarantee against the emergence of new competition. A few large firms may tolerate the existence of small firms as they do not threaten the big firms. They provide a superficial evidence that monoply does not exist in an industry.

**9. social utility:** Small scale industries are helpful in generating self-employment for a large number of persons. These industries are also useful in preventing the concentration of income and wealth. They facilitate the economic development of rural and backward areas. Small firms use local resources and their social cost is comparatively low.

**10. State assistance and patronage:** Small scale industries get several concessions from the Government on account of their social benefits. The Government provides them loans on concessional rates of interest Technical, managerial and marketing assistance is also provided. The Government has reserved several products for exclusive production in the small scale sector. Several institutions have been set up to protect and promote the growth of small scale industries in the country.

**11. Limited gestation period:** A small scale firm requires less time to start and to give results. Production lag (time required in converting inputs into outputs) is comparatively short. As a result small business provides quick and reasonable good yield on investment.

**Perfect Competition**

A perfectly competitive market is a hypothetical market where competition is at its greatest possible level. Economists argued that perfect competition would produce the best possible outcomes for consumers, and society.

Key characteristics

Perfectly competitive markets exhibit the following characteristics:

1. There is perfect knowledge, with no information failure or time lags.  Knowledge is freely available to all participants, which means that risk-taking is minimal and the role of the [entrepreneur](http://www.economicsonline.co.uk/Competitive_markets/Producer_supply.html) is limited.
2. There are no [barriers to entry](http://www.economicsonline.co.uk/Business_economics/Barriers_to_entry.html) into or exit out of the market.
3. Firms produce homogeneous, identical, units of output that are not branded.
4. Each unit of input, such as units of labour, are also homogeneous.
5. No single firm can influence the market price, or market conditions. The single firm is said to be a price taker*,* taking its price from the whole industry.
6. There are a very large numbers of firms in the market.
7. There is no need for government regulation, except to make markets more competitive.
8. There are assumed to be no [externalities](http://www.economicsonline.co.uk/Market_failures/Externalities.html), that is no external costs or benefits.
9. Firms can only make normal profits in the long run, but they can make abnormal profits in the short run.

**The firm as price taker**

The single firm takes its price from the industry, and is, consequently, referred to as a price taker. The industry is composed of all firms in the industry and the market price is where market demand is equal to market supply. Each single firm must charge this price and cannot diverge from i

Very few markets or industries in the real world are perfectly competitive. For example, how homogeneous is the output of real firms, given that even the smallest of firms working in manufacturing or services try to differentiate their product.

Although unrealistic, it is still a useful model in two respects. Firstly, many primary and commodity markets, such as coffee and tea, exhibit many of the characteristics of perfect competition, such as the number of individual producers that exist, and their inability to influence market price. Secondly, for other markets in manufacturing and services, the model is a useful yardstick by which economists and regulators can evaluate levels of competition that exist in real markets.

**The benefits**

It can be argued that perfect competition will yield the following benefits:

1. Because there is perfect knowledge, there is no information failure and knowledge is shared evenly between all participants.
2. There are no barriers to entry, so existing firms cannot derive any [monopoly power](http://www.economicsonline.co.uk/Business_economics/Monopoly.php).
3. Only normal profits made, so producers just cover their opportunity cost.
4. There is no need to spend money on advertising, because there is perfect knowledge and firms can sell all they can produce. In addition, selling unbranded goods makes it hard to construct an effective advertising campaign.
5. There is also maximum choice for consumers.

**Monopoly**

A monopoly is an enterprise that is the only seller of a good or service. In the absence of government intervention, a monopoly is free to set any price it chooses and will usually set the price that yields the largest possible profit. Just being a monopoly need not make an enterprise more profitable than other enterprises that face competition : the market may be so small that it barely supports one enterprise. But if the monopoly is in fact more profitable than competitive enterprises, economists expect that other entrepreneurs will enter the business to capture some of the higher returns. If enough rivals enter, their competition will drive prices down and eliminate monopoly power.

A pure monopoly is a single supplier in a market. For the purposes of regulation, monopoly power exists when a single firm controls 25% or more of a particular market.

Formation of monopolies

Monopolies can form for a variety of reasons, including the following:

1. If a firm has exclusive ownership of a scarce resource, such as Microsoft owning the Windows operating system brand, it has monopoly power over this resource and is the only firm that can exploit it.
2. Governments may grant a firm monopoly status, such as with the Post Office, which was given monopoly status by Oliver Cromwell in 1654. The [Royal Mail Group](http://www.royalmailgroup.com/portal/rmg) finally lost its monopoly status in 2006, when the market was opened up to competition.
3. Producers may have patents over designs, or copyright over ideas, characters, images, sounds or names, giving them exclusive rights to sell a good or service, such as a song writer having a monopoly over their own material.
4. A monopoly could be created following the merger of two or more firms. Given that this will reduce competition, such mergers are subject to close regulation and may be prevented if the two firms gain a combined market share of 25% or more.

**Key characteristics**

1. Monopolies can maintain super-normal [profits](http://www.economicsonline.co.uk/Business_economics/Profits.html) in the long run. As with all firms, profits are maximised when MC = MR. In general, the level of profit depends upon the degree of [competition](http://www.economicsonline.co.uk/Business_economics/Competition_and_market_structures.html) in the market, which for a pure monopoly is zero. At [profit maximisation](http://www.economicsonline.co.uk/Business_economics/Profits.html), MC = MR, and output is Q and price P. Given that price (AR) is above ATC at Q, supernormal profits are possible (area PABC).

 

1. With no close substitutes, the monopolist can derive super-normal profits, area PABC.
2. A monopolist with no substitutes would be able to derive the greatest monopoly power.

**Types of integration**

**Vertical Integration**

A company exhibits **backward vertical integration** when it controls [subsidiaries](http://en.wikipedia.org/wiki/Subsidiaries) that produce some of the inputs used in the production of its products. For example, an automobile company may own a [tire](http://en.wikipedia.org/wiki/Tire) company, a [glass](http://en.wikipedia.org/wiki/Glass) company, and a metal company. Control of these three subsidiaries is intended to create a stable supply of inputs and ensure a consistent quality in their final product.This occurs when one organisation takes over another at an earlier or later stage of production or work. Backward means that integration is at an earlier stage of production

Forward means the integration occurs in part of the process that is nearer to the customer. The main reasons for forward vertical integration are to make sure that a business:

* has somewhere to sell its product
* controls where and how it sells its product.

The main reasons for backward vertical integration are to ensure that a business:

* can get supplies
* has control over the quality of supplies.

### Example-Oil industry

Oil Companies, both multinational (such as Exxon Mobil,Shell, BP) and national (e.g. Petronas) often adopt a vertically integrated structure. This means that they are active along the entire supply chain from [locating deposits](http://en.wikipedia.org/wiki/Hydrocarbon_exploration), drilling and extracting [crude oil](http://en.wikipedia.org/wiki/Crude_oil), transporting it around the world, [refining](http://en.wikipedia.org/wiki/Refinery) it into petroleum products such as [petrol/gasoline](http://en.wikipedia.org/wiki/Gasoline), to distributing the fuel to company-owned retail stations, for sale to consumers.

#### Internal gains

* Lower [transaction costs](http://en.wikipedia.org/wiki/Transaction_costs)
* Synchronization of supply and demand along the chain of products
* Lower uncertainty and higher investment
* Ability to monopolize market throughout the chain by [market foreclosure](http://en.wikipedia.org/wiki/Market_foreclosure)
* Strategic independence (especially if important inputs are rare or highly volatile in price, such as rare earth metals)

#### Internal losses

* Higher coordination costs
* Higher monetary and organizational costs of switching to other suppliers/buyers
* Weaker motivation for good performance at the start of the supply chain since sales are guaranteed and poor quality may be blended into other inputs at later manufacturing stages

#### Benefits to society

* Better opportunities for investment growth through reduced uncertainty
* Local companies are often better positioned against foreign competition

#### Losses to society

* Monopolization of markets
* Rigid organizational structure

**Horizontal Integration**

This occurs when one organisation integrates with another business at the same stage of production or work. In  [business](http://en.wikipedia.org/wiki/Business%22%20%5Co%20%22Business), **horizontal integration** is a strategy where a [company](http://en.wikipedia.org/wiki/Company) creates or acquires production units for outputs which are alike - either complementary or competitive. One example would be when a company acquires competitors in the same industry doing the same stage of production. The main reasons were to:

* bring together people doing similar jobs
* give customers a better service
* achieve lower costs.

Lateral Integration

The acquisition of additional business activities that are at the same level of the value chain in similar or different industries. This can be achieved by internal or external expansion. Because the different firms are involved in the same stage of production, horizontal integration allows them to share resources at that level. If the products offered by the companies are the same or similar, it is a merger of competitors. If all of the producers of a particular good or service in a given market were to merge, it would result in the creation of a monopoly. Also called lateral integration.

**Conglomerate Integration**

This occurs when a business merges with another that produces a completely different product. A major reason for this is to try and spread risks by producing more than one product. A merger between firms that are involved in totally unrelated business activities. There are two types of conglomerate mergers: pure and mixed. Pure conglomerate mergers involve firms with nothing in common, while mixed conglomerate mergers involve firms that are looking for product extensions or market extensions. For example, many tobacco firms have bought businesses in areas such as hotels and leisure. There are many reasons for firms to want to merge, which include increasing market share, synergy and cross selling. Firms also merge to diversify and reduce their risk exposure. However, if a conglomerate becomes too large as a result of acquisitions, the performance of the entire firm can suffer.

**Economies of Scale**

**Economies of scale** are the cost advantages that enterprises obtain due to size, throughput, or scale of operation, with cost per unit of output generally decreasing with increasing scale as fixed costs are spread out over more units of output.

There are two main types of economies of scale: internal and external. Internal economies of scale have a greater potential impact on the costs and profitability of a business.

Internal economies of scale

Internal economies of scale relate to the lower unit costs a single firm can obtain by growing in size itself. There are five main types of internal economies of scale.

**Bulk-buying economies**

As businesses grow they need to order larger quantities of production inputs. For example, they will order more raw materials. As the order value increases, a business obtains more bargaining power with suppliers. It may be able to obtain discounts and lower prices for the raw materials.

**Technical economies**

Businesses with large-scale production can use more advanced machinery (or use existing machinery more efficiently). This may include using mass production techniques, which are a more efficient form of production. A larger firm can also afford to invest more in research and development.

**Financial economies**

Many small businesses find it hard to obtain finance and when they do obtain it, the cost of the finance is often quite high. This is because small businesses are perceived as being riskier than larger businesses that have developed a good track record. Larger firms therefore find it easier to find potential lenders and to raise money at lower interest rates.

**Marketing economies**Every part of marketing has a cost – particularly promotional methods such as advertising and running a sales force. Many of these marketing costs are fixed costs and so as a business gets larger, it is able to spread the cost of marketing over a wider range of products and sales – cutting the average marketing cost per unit.

**Managerial economies**As a firm grows, there is greater potential for managers to specialise in particular tasks (e.g. marketing, human resource management, finance). Specialist managers are likely to be more efficient as they possess a high level of expertise, experience and qualifications compared to one person in a smaller firm trying to perform all of these roles.

**External economies of scale**External economies of scale occur when a firm benefits from lower unit costs as a result of the whole industry growing in size. The main types are:

**Transport and communication links improve**As an industry establishes itself and grows in a particular region, it is likely that the government will provide better transport and communication links to improve accessibility to the region. This will lower transport costs for firms in the area as journey times are reduced and also attract more potential customers. For example, an area of Scotland known as Silicon Glen has attracted many high-tech firms and as a result improved air and road links have been built in the region.

**Training and education becomes more focused on the industry**Universities and colleges will offer more courses suitable for a career in the industry which has become dominant in a region or nationally. For example, there are many more IT courses at being offered at colleges as the whole IT industry in the UK has developed recently. This means firms can benefit from having a larger pool of appropriately skilled workers to recruit from.

**Other industries grow to support this industry**

A network of suppliers or support industries may grow in size and/or locate close to the main industry. This means a firm has a greater chance of finding a high quality yet affordable supplier close to their site.

An economic concept referring to a situation in which economies of scale no longer function for a firm. Rather than experiencing continued decreasing costs per increase in output, firms see an increase in marginal cost when output is increased.

### Diseconomies of scale can sometimes occur for the follow reasons: Duplication of effort

A firm with only one employee can't have any duplication of effort between employees. A firm with two employees could have duplication of efforts, but this is improbable, as the two are likely to know what each other is working on at all times. When firms grow to thousands of workers, it is inevitable that someone, or even a team, will take on a project that is already being handled by another person or team.

**Increase in communication Cost**

The one-on-one channels of communication grow more rapidly than the number of workers, thus increasing the time, and therefore costs, of communication. At some point one-on-one communications between all workers becomes impractical; therefore only certain groups of employees will communicate with one another (salespeople with salespeople, production workers with production workers, etc.). This reduced communication slows, but doesn't stop, the increase in time and money with firm growth, but also costs additional money, due to duplication of effort, owing to this reduced level of communication.

### Top-heavy companies

As a firm becomes too large, it becomes costly to keep control of a sprawling corporate empire and so often results in bureaucracy as executives implement more and more levels of management. As firms increase in size, managers will initially provide a net benefit to the firm and increase productivity, however, as a firm grows and covers a larger geographical area and/or employs more people, a principle agent problem arises, leading to lower productivity.

### Office politics

"Office politics" is management behaviour which a manager knows is counter to the best interest of the company, but is in his personal best interest. For example, a manager might intentionally promote an incompetent worker knowing that the worker will never be able to compete for the manager's job. This type of behaviour only makes sense in a company with multiple levels of management. The more levels there are, the more opportunity for this behaviour. At a small company, such behaviour would likely cause the company to go bankrupt, and thus cost the manager his job, so he would not make such a decision.